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Politics this week

Jan 9th 2003
From The Economist print edition

Building up

AP

United Nations inspectors intensified their search for Iraqi weapons of mass destruction, using helicopters for the first time, while America continued to deploy troops and make logistical preparations for a possible attack on **Iraq**. A confidential UN report estimated that some 500,000 Iraqis could be injured in the first phase of a war.

See article: Saddam defiant

Iraq and **Kuwait** had their first talks in four years about Kuwaitis missing since Iraq's invasion and the Gulf war. Saddam Hussein replaced his long-serving oil minister (formerly a weapons-programme overseer), General Amir Mohammed Rashid.

Two **suicide bombers** killed 22 people in an attack on Tel Aviv. Israel held back from strong military retaliation but banned Palestinian officials from attending a meeting in London. Ariel Sharon, Israel's prime minister, rejected charges in the Israeli press of financial impropriety, but his Likud Party continued to drop in the opinion polls.

See article: The suicide bombs in Tel Aviv

Israel's **Supreme Court** overturned a ban on two prominent Arabs standing for the Knesset.

See article: Israeli politics and sleaze

Two murderous attacks were attributed to **Algerian militants**. The first killed 13 members of two families; the second killed 40 soldiers in an ambush.

A military court sentenced 26 people to death for killing **Congo's** president, Laurent Kabila, two years ago. Joseph Kabila, who succeeded his father, must now decide whether the sentences should be carried out.

Two ex-generals will contest **Nigeria's** presidential election in April. Olusegun Obasanjo, the sitting president and a southern Christian, will represent the People's Democratic Party. Muhammadu Buhari, a former military ruler and a northern Muslim, was the only candidate wishing to represent the main opposition All Nigeria People's Party.

An uneasy ceasefire, organised by the French, was agreed between **Côte d'Ivoire's** government and rebel factions ahead of possible peace talks in Paris, but fighting continued in parts of the country.

Poisoners in town

Anti-terrorist police in **London** said they had found traces of ricin, a deadly—though not mass-destruction—poison, when they arrested six North Africans.

See article: Terror alert in London

Germany's public-sector trade-union, Verdi, which represents 2.8m workers, continued to threaten a nationwide strike over a wage claim.

See article: Schröder's struggle

Abnormally ferocious winter **weather** gripped most of Europe: -25°C (-13°F) in Moscow, -24°C in Helsinki and Stockholm. Even sea-girt Britain recorded -18°C in the Scottish highlands; Carcassonne, a low-lying area of southern France, reached -5°C; and, a rarity, snow fell on Venice.

EPA

Giving with the right hand...

The IMF said it was working with **Argentina's** government on an “interim programme”, under which it is expected to lend the country enough money to cover its debt repayments to the Fund itself for the next six months. The G-7 countries have been pressing the IMF to take a more lenient view of Argentina's needs.

See article: Argentina's fragile economic stability

Venezuela's currency plunged by 10% after the country's banks said they would close for two days in support of an opposition-led general strike, now in its fifth week, and aimed at toppling President Hugo Chávez.

Mexico's foreign minister, Jorge Castañeda, offered to resign. He was said to be frustrated by slow progress in talks on migration with America and domestic sniping at his tough line on Cuba.

See article: Mexico's politics

After statements of fiscal rectitude from **Brazil**'**s** new left-wing government, a rally of the country's currency and bonds continued.

See article: Lula's good start

Peru's Supreme Court struck down parts of a previous government's anti-terror laws, opening the way for thousands of terrorist prisoners to demand retrials.

See article: Cutting Peru's army down to size

John Manley, **Canada's** finance minister and an Ottawa MP, admitted that he had called a top banker to urge help for the Canadian capital's ice-hockey team. In hockey-mad Canada, few saw anything wrong in this.

See article: Neuroses and ice hockey

Running from president

Tom Daschle decided not to **run for president** but to stick to his current job as leader of the Democrats in the Senate; their former leader in the House, Richard Gephardt, said he would try again for the Democratic nomination, having been unsuccessful in 1988.

See article: Challenging George Bush

The 108th American **Congress** was convened. Nancy Pelosi became the highest-ranking woman in congressional history when she was sworn in as House minority leader.

President George Bush unveiled another **economic-stimulus** package, costing $670 billion: its main component is abolishing double taxation of dividends. Democrats said it was a sop to the rich.

See article: Bush goes for broke

An American journalist investigating a claim by Clonaid, a firm associated with a religious sect called the Raelians, that the world's first **human clone** has been born said that it could be an elaborate hoax.

“Number two”, the last of the **wolves** originally reintroduced to Yellowstone Park in 1995, was killed. The wolves survived a farmers' lawsuit aimed at their removal. There are now more than 160 of them; some of them ungratefully killed number two.

AP

War and peace

The United States offered to talk to **North Korea** about how it might meet its non-nuclear obligations. But the Bush administration said it would offer no new inducements to the North to end its efforts to develop nuclear weapons. North Korea has demanded a non-aggression treaty with America before offering any assurances about its weapons programmes.

See article: One last chance

The **Sri Lankan** government and the Tamil Tigers began a fourth round of talks aimed at bringing an end to 19 years of civil war and providing the island's minority Tamils with a homeland.

Hong Kong's chief executive, Tung Chee-hwa, said that the territory's traditionally low taxes would rise in the next budget, due in March.

China said that for the first time Taiwanese airliners could use Chinese airports between January 26th and February 10th, a holiday associated with the Chinese new year.

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Business this week

Jan 9th 2003
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Fixing Fiat

As **Fiat's** banks met to review a cost-cutting programme at the struggling Italian company's car unit, rumours emerged of a plan to spin off Fiat Auto to raise capital for the carmaker. Roberto Colaninno, a serial fixer of broken Italian companies, is preparing a rival rescue. The role of General Motors, which owns 20% of the car company and could be forced to buy the rest next year, is unclear.

See article: A saviour for Fiat?

GM responded to the launch of the latest Rolls-Royce by unveiling a competitor. The new model, sporting a **Cadillac** badge and featuring a huge V16 engine, will go into production only if it arouses interest from buyers. The last V16 Cadillac hit the market during the Great Depression.

Business for the **world's airlines** has improved a little, according to the International Air Transport Association: losses in 2002 added up to $13 billion, compared with $18 billion in 2001, and passenger numbers are forecast to rise this year. However, a soft landing is some way off: KLM Royal Dutch Airlines issued a second profits warning in five weeks, and British Airways said revenues would not rise this year.

Star in the east

Rupert Murdoch's long-standing aim of broadcasting to China came a little closer. China's government agreed that Mr Murdoch's **Star TV** should be allowed to beam its Mandarin entertainment channel, Xingkong Weishi, to posher hotels and foreign residents' compounds. **Phoenix TV**, 37% owned by Mr Murdoch's News Corp, won similar access for its news channel.

Brian Gilbertson shocked investors by quitting suddenly as chief executive of **BHP Billiton** because of "irreconcilable differences'' with the board. Mr Gilbertson, who masterminded the mega-merger in 2001 of BHP and Billiton, will be replaced by an American, Chip Goodyear.

See article: Controversy in the mining business

International Steel Group, forged from the remains of bankrupt LTV, offered $1.5 billion for **Bethlehem Steel**, itself in Chapter 11 bankruptcy. If the offer is approved by the courts, the deal will create America's biggest steelmaker and give ISG a high-grade steelmaking business to add to its operations.

See article: Surprising progress in America's steel industry

Diageo's attempts to consolidate its American drink-distribution business after its joint purchase, with France's Pernod Ricard, of Canada's Seagram could land it in court. National Wine and Spirits, a rival, says that the British firm's attempt to cut it out of distribution in Illinois breaks both state law and a previous agreement with Seagram.

William Morrison, Britain's fifth-largest supermarket chain, agreed to pay £2.9 billion ($4.6 billion) for the fourth-largest, **Safeway**. The merged company will be better placed to compete with Britain's big three: Asda, Tesco and Sainsbury's.

Kelly Martin became the new chief executive of **Elan**, an Irish drug company that saw its fortunes dive after coming under investigation by America's Securities and Exchange Commission for accounting

irregularities. Mr Martin's lack of experience in the industry stimulated speculation about a break-up of the firm.

Breaking the pact

The European Commission issued warnings to those big EU member states, Germany, France and Italy, under the **stability and growth pact**, for their excessive budget deficits. Its harshest criticism was aimed at Germany, which is likely to breach the pact's ceiling for deficits of 3% of GDP both in 2002 and 2003. Germany may face sanctions, including possible fines, if it does not rein in its deficit.

See article: German reform prospects

The European Commission formally launched an investigation into a plan by the French government to rescue **France Telecom** through the provision of loans to the tune of *euro*9 billion ($9.4 billion).

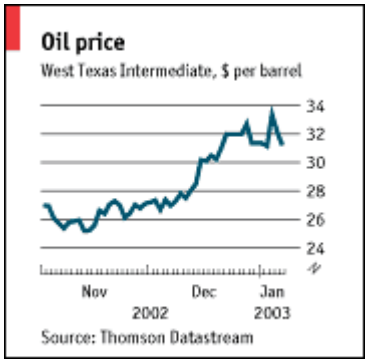
Pershing launched

Credit Suisse attempted to shore up its business after big losses in investment banking and insurance. CSFB announced the sale of Pershing, its clearance unit, to Bank of New York for $2 billion as part of the Swiss company's retreat from non-core activities.

China's fledgling capitalists seem to have got the hang of western-style business practices quickly. A government investigation of some 200 firms found many instances of poor corporate governance, inaccurate accounting, inflated profits and the like. On the bright side, a probe of the firms' auditors concluded that “overall quality is improving”.

Oil strike

OPEC called an emergency meeting to discuss increasing production quotas as oil prices stayed over $30 a barrel, above the cartel's $22-28 target range. Fears of a war in Iraq have forced prices up; a strike in Venezuela has worsened the problem.



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Fighting terrorism

Is torture ever justified?

Jan 9th 2003
From The Economist print edition

Even faced with monstrous terrorism, democracies break the taboo at their peril

HOW can democratic governments best fight an enemy like al-Qaeda, whose operatives are encouraged to outdo each other in the barbarity of their attacks? In ways that uphold the values democracies stand for, is the answer one would like to give. Yet faced with the sort of threat al-Qaeda poses, this line is not always so easy to draw.

Western democracies have long upheld the international ban on torture, and have publicly criticised other governments that violate it. The Bush administration has lambasted the Iraqi regime for torturing its opponents and has issued reports about similar abuses in other countries. But in its efforts to defeat al-Qaeda, is the American government itself now quietly sanctioning the use of some forms of torture?

Ends and means

A detailed account of American interrogation methods appeared recently in the *Washington Post.* The article quoted American officials who describe beatings and the withholding of medical treatment, as well as “stress and duress” techniques, such as sleep deprivation, hooding, and forcing prisoners to hold awkward positions for hours. The officials also say they sent alleged terrorists and lists of questions to countries known for far harsher interrogation techniques.

Although well documented, the account has produced official denials and only a desultory discussion among American commentators, who seem no keener to discuss the subject than the British and French were when the issue arose in Northern Ireland and Algiers. This is understandable. But to evade the question is hypocritical and irresponsible. By speaking anonymously about their interrogation methods, the officials seem to be asking for help: how far should they go in trying to elicit information to stave off another large-scale terrorist attack? They deserve an answer.

One of the few commentators brave enough to take this question seriously has been Alan Dershowitz, a leading American criminal-defence lawyer. He poses the “ticking-bomb” scenario. Suppose you know that there is a bomb about to go off which could claim thousands of victims. You have good reason to believe that a prisoner knows where it is, and that torture may force him to tell. Would you allow him to be tortured? Most people, however reluctantly, answer “yes”.

After September 11th, this is no longer just a theoretical prospect. This week in London, anti-terrorist police arrested a group of men, possibly members or supporters of al-Qaeda, who had apparently been manufacturing ricin, a deadly toxin. If that is so, the authorities will want to know how much was made, where it now is, and who else was involved. Possibly, lives will depend on finding the answers. In circumstances such as those, one can readily imagine intelligence officers quietly saying, “If only we could really lean on these people.”

Mr Dershowitz argues that the new threats do justify a limited use of non-lethal torture in extreme cases, and proposes that judges be able to issue “torture warrants”. His solution is the wrong one. But he is right that the threat of more catastrophic terrorist attacks creates genuine dilemmas.

A first point is that the “ticking-bomb” scenario is not as clarifying as one would wish. If torture is to be allowed, then how much cruelty would be permitted? Would threats against the prisoner's family be all right? His neighbours? His country? Even the extreme circumstance of a “ticking-bomb” threat offers no clear guidance to how far you might go.

But the bigger problem is with Mr Dershowitz's solution. Even if you allow, as many will not, that torture might be justified under the most extreme circumstances, it would be difficult to confine its use to those very rare cases. Any system that allowed torture in tightly controlled situations would risk eroding into wider use. To legalise is to encourage. Israel tried to limit use of physical coercion to extreme cases, but its security forces have ended up using such methods far more widely than was initially foreseen.

If America were to sanction torture, to begin with in extremely rare cases, there might be some immediate gains in security. Much as one would like to believe that torture never succeeds in extracting vital information, history says otherwise. But, for the democratic West, any such gains would be outweighed by greater harm. The prohibition against torture expresses one of the West's most powerful taboos—and some taboos (like that against the use of nuclear weapons) are worth preserving even at heavy cost. Though many authoritarian regimes use torture, not one of even these openly admits it. A decision by the United States to employ some forms of torture, no matter how limited the circumstances, would shatter the taboo. The morale of the West in what may be a long war against terrorism would be gravely set back: to stay strong, the liberal democracies need to be certain that they are better than their enemies.

George Bush has said that the fight against al-Qaeda is a battle for hearts and minds, not just a matter of military power. Though critics focus on his sabre-rattling, Mr Bush has been consistent in his claims to be defending human rights and democracy, and he has persisted in reaching out to Muslims, though he rarely gets credit for this. To keep the moral high ground, he needs to bolster public disavowals of torture by specifying the methods American interrogators can employ, by enforcing the limits, and by desisting from handing prisoners over to less scrupulous allies.

Choosing sides

There is room for discussion about what the limits should be. Given the gravity of the terrorist threat, vigorous questioning short of torture—prolonged interrogations, mild sleep deprivation, perhaps the use of truth serum—might be justified in some cases. Such tactics have ambiguous standing in international law. Some are occasionally employed against ordinary criminals. But there is a line which democracies cross at their peril: threatening or inflicting actual bodily harm. On one side of that line stand societies sure of their civilised values. That is the side America and its allies must choose.

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George Bush's new tax cuts

Who dares wins

Jan 9th 2003
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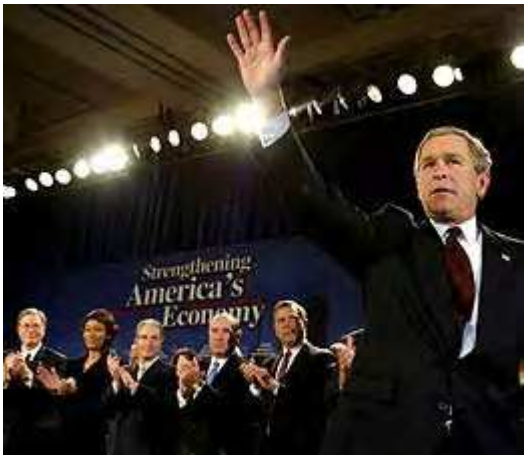
The president has surprised America with another bold tax initiative

Reuters



TAX proposals always bring out the worst in politicians. Whether it is higher taxes or lower taxes, you can count on synthetic rage on one side and equally bogus devotion to the greater good on the other. So it proved this week when George Bush unveiled his "jobs and growth" package of tax cuts (see article). It brought forward some of the cuts announced earlier, and had some bits of new help for the unemployed. But its central and, in terms of forgone revenue, much the most expensive component is the elimination of the tax on dividends. A cynical political ploy, gasped Democrats: yet another windfall for the rich masquerading as an economic-stimulus plan. A fair and balanced proposal, says the administration, just the shot in the arm the economy so badly needs.

Following the proper fiscal form, there is truth on both sides. Cynical or not, the plan is a ploy: make no mistake about that. The package will have next to no stimulative effect in the relevant time-frame—and, if the administration succeeds in pushing it through, by the time the proposal does inject some extra demand it may well do more harm than good. The president is using the economic slowdown to advance a boldly ideological tax-cutting agenda that has nothing to do with stabilisation policy. And yet the White House need not be ashamed of this feint, because the idea of eliminating the tax on dividends happens to be a good one.

Forget the jobs part of "jobs and growth": the plan will have little effect on employment, one way or the other. But it may well give long-term growth in productivity a nudge in the right direction. The reason is that eliminating the tax on dividends lowers the burden of taxation on savings, relative to the burden of taxation on consumption. And that is good because, taking the overall tax haul as given, America seriously overtaxes savings and seriously undertaxes consumption. This inhibits the accumulation of capital and probably depresses long-term growth. It also encourages excessive indebtedness, which makes the economy more fragile (see article).

So the Democrats' fury over the dividend-tax proposal, taken in isolation, is sadly misplaced. They are on much firmer ground in criticising the administration's devil-may-care attitude to long-term budget prospects. Large deficits are looming on present trends, and this plan, despite the gentle boost to growth that may be hoped for, is going to make that problem worse. It is also true, notwithstanding the president's evasions, that the plan moves more of the burden of taxation from rich to poor. If Mr Bush wants to be taken seriously as a tax reformer, he must strive to do good supply-side things to the tax code while curbing future deficits and treating taxpayers more equitably. That is not an impossible task by any means, but it requires thinking of a strategic rather than tactical kind. Possibly that is not the president's greatest strength. Alternatively, Mr Bush may not give a damn whether he is taken seriously as a tax reformer.

Will he get his plan through? People are learning not to underestimate the remarkable Mr Bush—though even he will have his work cut out in this case. With Democrats foaming at the mouth and the Senate evenly divided, he will need rock-solid support from Republican senators. The signs are he will not get it: John McCain and others are saying that the plan goes too far. Even so, with a concession or two, the president is hoping to end up with more than people thought he would dare ask for just a few weeks ago. He is making a habit of that.

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The IMF and Argentina

A bad deal

Jan 9th 2003
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The IMF's shareholders are on the point of making a big mistake

AFTER months of negotiation, Argentina seems about to get a new loan from the International Monetary Fund. If it does, it will not be because the Argentine government has adopted a sensible programme of economic reforms. It will be because the Fund has been instructed by its political masters in the G7 group of rich countries to announce a short-term bare-bones loan, preferably by January 17th. This would be a bad deal, signed at the wrong time and for the wrong reasons.

The plan is to give Argentina a temporary “transitional” loan that will see the country through its presidential election, currently scheduled for April 27th. The Fund is not offering any new money in net terms—at just under $3 billion, the loan will be just enough to let Argentina repay the IMF what it already owes up to August. No serious structural changes will be demanded in return. Nobody, not even Argentina's champions in the G7, believes this loan will help to get the country out of its mess.

So why make the loan at all? The answers are not pretty. This deal is designed partly to assuage the rich countries' guilt over the extent of Argentina's mess, and their role in creating it. And it is partly a capitulation to highly effective Argentine pressure. January 17th happens to be the day that Argentina is due to repay the IMF almost $1 billion, a payment that Buenos Aires was refusing to make without a new IMF agreement.

Of the two, the guilt is the more forgivable. Argentina's self-inflicted economic mistakes over the past year have been compounded by its treatment by the IMF. A year ago, the Fund switched from being Argentina's chief cheerleader into an extremely tough cop. Smarting from criticism that it had turned a blind eye to loose budgets and an unsustainable fixed exchange rate, the Fund's staff were determined not to conclude yet another weak deal. At the time many observers, including *The Economist*, accepted that there might be a case for helping the country through its chaos with a new loan, even if the plan had only a fighting chance of success. But Argentina never came up with a remotely plausible plan. Despite this, and as negotiations dragged on, the economy reached a fragile stability even without a Fund agreement (see article).

For some in the G7, the goal of a loan now should be to mitigate Argentina's pain, which has seen living standards fall precipitously and millions drop into poverty. But by forcing the IMF to cave in on virtually all areas of disagreement, the G7 has ensured that this new loan, if it goes ahead, will be terribly weak. It will do nothing about Argentina's fundamental problems, notably the need to overhaul its public finances and restructure the banking system. Worse, it is doubtful that this loan will even provide stability until the election. The budget on which the deal is based is shaky at best. The legal uncertainties that hang over Argentina's entire financial system remain. The only plausible benefit is that the man on the street in Buenos Aires might feel better about his country's prospects thanks to the mere existence of an IMF agreement. If the G7's goal is to help Argentina, this is a bad way to go about it.

The G7's other motive—to avoid more Argentine defaults to multilateral financial institutions—has even less merit. Since mid-November, when Argentina refused to honour an $800m repayment to the World Bank, the country has made clear that it would not repay any multilateral creditors unless there was a new IMF agreement. Argentina is a big borrower, not just from the IMF but also from the World Bank and the Inter-American Development Bank. A prolonged Argentine default could damage these institutions' credit ratings. To avoid this, the G7 have “evergreened” Argentina's loans: that is, they have given out

just enough money to avoid default. Banking regulators frown on this behaviour, as it is often used to disguise bad loans. It is shameful that the G7 should now practise it.

Credibility in shreds

Furthermore, such blatant political interfering deals yet another blow to the Fund's standing as an independent entity. Other debtors will no doubt now wonder if they too can get bare-bones loan packages with no reforms necessary. And the G7 has sent a clear signal about multilateral debts: if you owe the IMF and World Bank enough, you can try a form of blackmail. Since the international institutions are owed huge sums of money by developing countries that have borrowed from them during recent financial crises, this is a message both the Fund and its shareholders may come to regret.

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Company boards

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Jan 9th 2003
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How to strengthen corporate governance

BY ANY standards, last year was a lousy one for corporate governance. It saw a succession of scandal-strewn bankruptcies, including those of WorldCom, Conseco and Global Crossing, respectively the world's first, third and sixth biggest ever. Europe had its share of scandals too: Marconi, Vivendi and ABB covered themselves in mire. No wonder so many countries are dreaming up new governance rules. No wonder, too, that corporate boards are in the spotlight (see article). Boards are the links between managers and investors—and so potentially the most effective instrument of good governance and constraint on a chief executive.

Unfortunately, the corporate world is littered with examples of boards that have failed miserably. Some have allowed a bullying boss to talk them into a lavish pay award; others have nodded through a lack of strategy or a bad acquisition. Just one egregious example: at Global Crossing, the chief executive's employment contract not only set out the make and model of the Mercedes the company would buy him and promised a monthly first-class air ticket for his mother to visit him, but gave him a $10m cash bonus and $20m of stock options merely for agreeing to take the job.

New governance rules, such as those the Securities and Exchange Commission (SEC) is now considering, may put a stop to some of the worst cases of board failure. They are certainly a way to accelerate the spread of best practice. Many things that rule-makers are proposing, such as genuine independence in the boardroom, financial expertise on the audit committee and a system under which independent directors meet together without any executives present, are practices that the best-governed American companies already follow. One welcome move is to ensure that independent directors have a leader who can represent their views to the chief executive and talk to outside investors. That person might best be a non-executive chairman; or he could, as a new report from the Conference Board recommends, simply be one of the directors. What matters most is that the chief executive is willing to listen to and accept criticism from the board.

Where are the investors?

Better structures cannot alone guarantee that companies are well run. For proof, look at Enron. On paper, the company's corporate governance was admirable: it had split the roles of chairman and chief executive, and its audit committee was run by a distinguished accountancy professor. What counts in the end is how directors behave and what questions they ask, not whether they have an ethics policy in place or can explain why they do not have a finance professional on the audit committee. Such requirements

may shove laggards along a bit, but they will not stop the greedy or perverse. For that, boards need help from outside, and above all from investors.

Investors are, after all, a company's owners. Global Crossing's pay contract was public knowledge; yet the directors who agreed to it were not booted out by infuriated investors. The surest way for governance to improve is for investors to demand it. In the past, it has been hard to see a link between better governance and financial performance. But new work by Paul Gompers of the Harvard Business School and two colleagues strongly suggests that well-run companies, responsive to shareholders, earn higher returns than management dictatorships. So it is rational for investors to take more interest.

Institutional investors, who have the muscle to make a difference, still often shut their eyes. Sometimes they feel they have to. Asset managers who take too much interest in a company's boardroom foibles may find that the company takes its pension fund and 401(k) money away from them. Although trustees act only in the interests of a fund's beneficiaries, they are still vulnerable to a chief executive inviting them to move money away from a trouble-making manager. Trustees may need better protection against such urgings.

When he was at the Securities and Exchange Commission, Harvey Pitt proposed a rule under which money managers would have to tell clients how they had voted on proposals at annual general meetings. Those proxy votes would include votes on pay. Many in the industry hate this idea and hope to kill it. They are wrong: letting in a little daylight on how institutional investors vote on shareholders' behalf might help to put the power of the market, and not just that of regulators, behind better corporate governance.

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London

The best and worst of places

Jan 9th 2003
From The Economist print edition

London needs a stronger city government

AS A rough but powerful indicator of the economic health of a city, look at where the world's poor want to go. Those who smuggle themselves into western Europe seeking a better life are not, by and large, aiming for Paris or Berlin; nor do they cross the Channel clinging to a train in a desperate bid to get to Birmingham or Liverpool. They head for London.

Over the past 20 years, London has transformed itself into the world's most important international financial centre and the engine of the British economy. Whether you're an illegal immigrant who wants a job tomorrow, no questions asked, or a financier who wants to make a quick million, not many questions asked, London's the place to be.

But there is a downside to London's dynamism, reflected in its residents' passionate ambivalence towards their city. It's a wonderful place, and it stinks.

Blame Westminster and Whitehall

Although it is the richest part of Britain, London has the country's worst public services. Whether you spend your morning commute inhaling the fumes of a traffic jam or the muskier odours of a sardine-packed train, you have to go a long way to find a city with a worse transport system. London's Metropolitan Police, according to a recent report by Policy Exchange, a think-tank, rank 40th among England and Wales's 42 police forces. You are now four times as likely to be mugged in London as you are in New York. London's accident and emergency services are worse—as measured by the proportion of patients seen within an hour—than anywhere else in England and Wales. And Inner London's 11-year-olds perform worse in tests than those anywhere else in the country.

For London's poor, all this makes life worse than it otherwise should be. For London's better-off, it makes life more expensive. Rather than sit for hours in the waiting rooms of overstressed GPs or see their children fail, prosperous Londoners buy into private health and private schools.

Now that growth is faltering (see article), pressure on the public services will ease. That gives Britain the opportunity to ignore the causes of London's problems—or do something about them.

When New York was in a mess, it took Rudy Giuliani's abrasive determination to sort the place out. But even if London's mayor, Ken Livingstone, were the right man, he doesn't have the power. Planning powers in London lie with 32 boroughs. Financial power lies with central government. London's interests fall through the gap between them.

London's problems spring from the way Britain is governed. The power of national government in Britain, which is probably the most centralised country in the world after North Korea, explains why the public services are so bad. Central government raises 96% of tax revenue; and each year the Treasury takes a net £10 billion-20 billion ($16 billion-32 billion) out of London's £150 billion economy to distribute around regions which already have markedly better public services than the capital does.

More power to London's mayor would also help sort out transport. Mr Livingstone is moving in the right direction in introducing a charge for driving in central London next month. But he cannot, for instance, do much to promote Crossrail, a fine scheme for a rail link across London from Heathrow to the City which has been tossed between London's boroughs, Parliament and the Treasury for 20 years.

But London's anarchic energy is one of its strengths, argue supporters of the status quo; and there's something in what they say. In the early 1980s, for instance, the Corporation of London, the authority that runs the City of London, the tiny central financial district, was hostile to development. Competition from Docklands, in the boroughs on the City's poorer eastern border, drove the Corporation to loosen up, pushing down the cost of rents. That's a fine way to run a city in which things are trundling along comfortably. But only a powerful authority can push through the change that was needed in New York a decade ago, and is needed in London now.

It may take a crisis to persuade the government of that. Remember how important Mr Giuliani was in pulling New York through the aftermath of September 11th? It is hard to imagine that London's 32 squabbling boroughs, weak mayor and meddling central government doing anything like as well if, God forbid, anything like that happened here.

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Letters

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From The Economist print edition

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In the pink

SIR – The view that Barbie pink is a "particularly nauseating hue" is entirely subjective and shows that the author of the article is no fashionista ("Life in plastic", December 21st). In fact, the colour is "hot" in certain fields. Two examples spring to mind: a new fashion school in Orange County, California, is decked out in that hue and I read of a new bar complex in London's Soho of a similar tint. One hopes that those who frequent these establishments do not suffer environmentally triggered nausea. If unusual colour choices are to be met with gratuitous derision, what will you allow to be said of unusual political, moral, religious or sexual choices? Colourism does not become you. And who knows? Perhaps Barbie pink will become the official hue of "Marx after communism" (December 21st).

David Eno
Los Angeles

SIR – After reading an article on Marxism followed immediately by one on Barbie (and Barbieism?), I toyed with the idea of replacing instances of the word Marx with the word Barbie and vice versa to see if there were any deeper meanings. A few experimental sentences did not reveal any secrets. Unfortunately, I am unable to play either article backwards to look out for any subliminal message. Perhaps you could tell us what it was.

Carl Adler
Hardinghen, France

Rebadging Trevor

SIR – Car designers certainly are a self-consciously suave bunch, including "Trevor Ford", to whom you refer ("Putting on the style", December 21st). However, his name was Trevor Frost and he changed it not to Trevor Fiorino but to Fioré. He moved from his native Sheffield to Turin to accelerate his career and image in the early 1970s. Easy mistakes to make when it comes to the car world, especially as he worked for a time at a long-established Italian car-design company called Fissore. Indeed, the Fiorino is a long-obsolete Fiat van.

For the less stylish among us—maybe even the more anorakish—his work includes the Trident sports car, the Bond Equipe 2 litre, several Citroën concept cars during his spell with the company and the interior of the Renault 25.

Giles Chapman
London

Taking responsibility

SIR – Corporate social responsibility (CSR) is as much about respecting the rights of shareholders as of any other stakeholder group ("Lots of it about", December 14th). In fact, investors have become a force in arguing that the economic, social and environmental impacts of business are integrally linked. Anyone who asserts that business is not making a contribution to the well-being of society in material ways is foolish. The same charge can be levelled against those who fail to acknowledge that there are widely accepted business practices that are unethical, harmful and wrong.

It is not the position of anyone I know in the CSR community that the simple remedy for fixing what needs attention is “bullying” by government. However, government has a legitimate and vital role to play in supporting an infrastructure encouraging of commerce, setting minimum standards for business conduct, incentivising desirable policies and practices, and penalising those who do not abide by societal norms.

Robert Dunn
CEO
Business for Social Responsibility
San Francisco

SIR – You say that building a fairer society is the job of government. This can be interpreted as saying that private corporations have no responsibility to assist in this aim. A corporate citizen who shows apathy and complacency toward the contribution of volunteer initiatives to make society around the corporation, and the society from which it benefits, better and fairer displays inaction based on a dereliction of civic duties. Even though civic responsibility cannot be mandated by law or regulation, any visionary executive will consider it a moral obligation and will lead his company to become a volunteer partner with government to build a fairer society.

Joy Cherian
President
Association of Americans for Civic Responsibility
Washington, DC

SIR – Henry Ford was generous with his workers, though not as generous as you would have it. In 1914, he offered a minimum wage of $5 per day, not per hour, although even at that lesser rate he upset managers at other firms.

Bruce Miller
Raleigh, North Carolina

Dog's body

SIR – The Kennel Clubs of the world should drop their elitist pedigree standards and classify show dogs based only on appearance and behaviour (“It's a dog's life”, December 21st). The same exacting criteria can still be applied for selecting the best example of each breed but a greatly expanded gene pool would be available to those who want to create the perfect poodle. Chihuahuas, Welsh corgis, and pugs could still have the desired ridiculous look. However, instead of being inbred monstrosities, they would be outbred monstrosities and would perhaps lead longer and healthier lives.

Georg Jander
Ithaca, New York

Not in the Post

SIR – In your article on conspiracies you erroneously attribute to the *Jerusalem Post* a report “which mistakenly said that 4,000 Jews had ‘disappeared' in the [September 11th] disaster” (“That's what they want you to believe”, December 21st). This, you suggest, is probably the origin of the rumour that “Jews who worked in the twin towers had been secretly warned to stay away that day.”

Nowhere in our reporting of that day did the *Post* publish anything of the kind. A story in our internet edition did say that the Israeli foreign ministry had collected the names of 4,000 Israelis believed to have been in the areas of the World Trade Centre and the Pentagon at the time of the attack. Whether this story was the origin of the rumour, I cannot say. What I can say is that there was no mistake in our reporting.

Bret Stephens
Editor-in-chief
Jerusalem Post
Jerusalem

Cheques and balances

SIR – Your article on terrorist finance reminds me of my own recent experience of the extraordinary vigilance of Barclays bank in preventing suspected terrorists from opening an account ("The needle in the haystack", December 14th). As a customer for some 37 years, I accompanied my son when he went to open an account at a branch in England. He was born in Tokyo, has British nationality and had recently completed a degree course at an American university. He took along his passport and a letter of acceptance for a masters course from Middlesex University. A bank employee input his details into a computer and told us he could not open an account because he "did not fall into any category". Nothing was lacking in this stringent vetting procedure except, perhaps, the tiniest grain of common sense.

Bill Roff
Tokorozawa, Japan

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Torture

Ends, means and barbarity

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Torture has been outlawed in all circumstances everywhere. But global terrorism may be leading America to bend the rules

THE reports have been emerging only slowly, but they are chilling. American intelligence agents have been torturing terrorist suspects, or engaging in practices pretty close to torture. They have also been handing over suspects to countries, such as Egypt, whose intelligence agencies have a reputation for brutality.

Some may shrug at this. More than a year ago, after all, the world was shocked by pictures of blindfolded and shackled al-Qaeda suspects being “processed” at the American naval base in Guantanamo Bay, in Cuba. They seemed to show that America would treat its terrorist prisoners just as nastily as it pleased.

That, however, was a different case. Those photographs were of prisoners under restraint, during transport, to prevent them attacking their captors. America had just suffered the world's most horrific terrorist attack, carried out by a group of determined suicides. Extreme precautions were justified. Since the arrival of those first inmates at Guantanamo, visits to the base by the International Committee of the Red Cross and by journalists accord with American denials that anyone is being tortured there.

Recent reports of the ill-treatment of prisoners held by America, or at America's behest elsewhere, are another matter. If, in their efforts to defeat al-Qaeda, American officials are moving towards a policy of using torture on a systematic basis, or conspiring with other countries to do so by handing over suspects to them for interrogation in the full knowledge that torture will be used, this would be a remarkable and ominous reversal of policy.

A cry for clarification

So far, American policy has been to eschew torture in even the most extreme cases, and to condemn openly its use not only by regimes of which America disapproves, such as Iraq and North Korea, but of allies as well, such as Saudi Arabia and Jordan. Senior American figures, from Donald Rumsfeld, the defence secretary, to Colin Powell, the secretary of state, have insisted that America is abiding by international agreements banning torture. Lower-level spokesmen, when asked about interrogation methods, continue to deny absolutely that America has breached such agreements.

Unfortunately, that is not what American officials directly involved in interrogating terrorist suspects have been telling reporters. The most detailed account of these, a long article in the *Washington Post* at the

end of December, quotes these officials as claiming that prisoners are being subjected to a range of “stress-and-duress” techniques such as hooding, sleep deprivation, being held in awkward positions and, in some cases, denied painkillers for injuries. They are sometimes beaten, too. One official puts it bluntly: “If you don't violate someone's human rights some of the time, you probably aren't doing your job.”

These interrogations are being conducted, claims the *Post*, at Bagram air base outside Kabul, Afghanistan's capital, and on Diego Garcia, an island in the Indian Ocean which the United States leases from Britain, putting it beyond the reach of American courts. In addition, officials are quoted as saying that many prisoners have been transferred to the intelligence services of other countries—Jordan, Egypt and Morocco are named—well-known for using brutal methods of interrogation.

Sometimes these transferred prisoners (“extraordinary renditions” in the euphemism), are sent with lists of specific questions that American interrogators want answered. Other transfers are made on a “don't ask, don't tell” basis, with American officials taking no part in directing or overseeing subsequent interrogations, but happy to receive any information gleaned from them. According to some officials, fewer than 100 captives have been involved in such transfers, but thousands have been arrested and held with American assistance in countries that are known for the brutal treatment of prisoners.

There seems little reason to doubt the veracity of the *Post* article. The newspaper's team of reporters claim to have spoken to ten current American security officials, some of whom have personally witnessed the handling of prisoners, as well as several former intelligence officials. More important, though the officials directly involved have spoken anonymously, they seem intent on sending a message: We are doing these things because we think we have to, and we want people to know.

After September 11th, similar anxiety was heard from officials at the FBI: in their desperation to get terrorist suspects to talk, they might, they admitted, have to use torture. That moment passed. This time, at least some American officials seem to be seeking absolution for violent interrogation methods which are illegal but which, reports the *Post*, they feel are “just and necessary”. “They expressed confidence that the American public would back their view,” says the newspaper.

It would probably be closer to the truth to say that the American public would rather not know. The reaction to these relevations, grave though they are, has been remarkably muted. Human-rights groups have issued condemnations, and other commentators have expressed dismay. But, so far at least, congressmen have not been demanding investigations.

The argument of necessity

It is tempting to argue that torture is justified in rare cases. In America, the most notable exponent of this position is Alan Dershowitz, a leading criminal-defence lawyer, who has argued, in cases of “ticking-bomb” urgency, for “torture warrants”. In practice, however, attempts to use torture sparingly have quickly led to widespread abuse. The most relevant case is Israel, where the ticking-bomb rationale has been used to justify the “physical coercion” of terrorists during interrogations (Israel has always refused to call it torture). This practice has never been explicitly legalised, but received something close to legal sanction after a commission headed by a former Supreme Court justice recommended in 1987 that “moderate physical pressure” in interrogations should be allowed after psychological pressure had failed. For years after that, the Israeli Supreme Court declined to take torture cases. But the abuse of Palestinian prisoners became so widespread, and so routine, that in 1999 the Supreme Court unanimously ruled that the coercive methods employed by Shin Bet, the security service, were illegal. Nevertheless, according to human-rights groups, the regular torture of Palestinian detainees has continued.

Elsewhere, too, torture that seemed justified in special cases has come to be applied almost indiscriminately. During Algeria's revolt against France in the 1950s, torture became the primary method of interrogating Algerian prisoners. It was often accompanied by summary executions of prisoners whether they talked or not, according to General Paul Aussaresses, who carried out many of the interrogations and unabashedly described them in a book which caused an outcry in France. Argentina's junta of 1976-83, facing a real terrorist threat from leftists and claiming to fight in the name of Christianity, routinely used torture which led to the execution of thousands of innocent people.

Does torture work in fighting terrorism? In the short term, it obviously can. After all, Guy Fawkes confessed (see article). Israeli security officials say they have prevented many terrorist attacks with

information gleaned from coercive interrogations. The French authorities claim to have won the battle of Algiers, and the Argentinian junta defeated its leftist opponents. But these victories have come at a cost, and have limits. Harsh Israeli interrogations have not stopped the suicide bombings, and have left many Palestinians embittered. France's brutal methods in Algeria divided the French themselves, and led a few years later to the granting of Algerian independence. Argentina's military dictators were toppled by popular resentment, and the country is still struggling to come to terms with the legacy of their anti-terrorism campaign.

If America does decide to employ torture systematically against al-Qaeda suspects, it would also have to take wider considerations into account. This decision would be a stark departure. Torture's prohibition has rapidly become one of the most universal features of international and domestic law. All the major human-rights agreements concluded since the second world war contain absolute bans on torture, with no exceptions. No domestic legal system officially allows it. Judging solely by the texts of laws and international agreements, torture is firmly beyond the pale, and torturers are outlaws.

Wrestling with a taboo

And yet torture, of one sort or another, is also widely practised, and as many people may be being tortured today as at any time in human history. According to Amnesty International, the torture and ill-treatment of prisoners continue to be recorded in more than 130 countries, and are widespread or persistent in 70 of those. A stream of reports from Amnesty and other human-rights groups describe beatings, electric shocks, rape, floggings, suffocation and a horrific litany of other torments.

Despite this, it would be a mistake to believe that the taboo against torture is meaningless. In democratic countries it is generally observed, though overzealous policemen will occasionally lapse. The taboo against torture is also strongly and deeply supported by western public opinion. If America, covertly or openly, begins to use torture systematically against al-Qaeda suspects, there is bound to be a backlash, both at home and abroad. Many of the subjects might be innocent people, which would be morally repellent—and would hand a propaganda victory to Islamic extremists.

Another problem will be maintaining co-operation with America's European allies. Their hands may not be entirely clean either, but European governments take international treaties seriously and some, such as Britain and Spain, signed up to the many international prohibitions against torture even while facing determined domestic terrorists of their own.

Nevertheless, the threat posed by al-Qaeda is hard to exaggerate, and preventing more attacks is urgent. Intelligence, including information from suspects, is a primary tool for doing this. If a suspect will not talk, and does not succumb to the sophisticated psychological techniques of which the FBI and CBI were once so proud, is there no scope to apply more pressure?

There may be. The definition of torture in international treaties is either so broad as to rule out even normal interrogation methods widely accepted in democracies, or vague enough to allow some practices which might seem harsh. For example, the Convention Against Torture of 1984 states that torture “does not include pain or suffering arising only from, inherent in or incidental to lawful sanctions.” In the case of potentially dangerous and suicidally determined terrorist suspects, a lawyer might argue, this allows the stress involved in some physical restraints, as well as bright lights, prolonged interrogations, mild sleep deprivation and the withholding of some creature comforts.

Judges have had few opportunities to draw clear lines about what is, or is not, allowed under international treaties. One of the most interesting rulings has been that of the European Court of Human Rights in 1978, concerning the treatment of suspected IRA prisoners by the British authorities. A majority of judges found that it was not torture to be made to stand spread-eagled against a wall for hours, to be hooded, to be deprived of sleep, to be given short rations or to be subjected to continuous loud noise. They nonetheless found such practices “inhuman and degrading”, and therefore in breach of the European Convention on Human Rights. What is clearly ruled out is the direct infliction of physical pain, or the threat of it. “Truth serums”, on which some pin their hopes, have an ambiguous standing under these treaties, but are in any case deemed ineffective (see article).

One tactic, however, is clearly forbidden in both domestic and international law: handing over suspects to someone else to torture. This is explicitly ruled out in the Convention Against Torture. Moreover, no court in any democratic country, including the United States, would agree to send a defendant to another country if it were known that he would be tortured there. America, therefore, seems already to be

allowing its frustration to lead it to bend, and probably break, the law. Hard though the choice is, it would be good if America stopped.

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Torture in history

The sight of the rack

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Modern lessons from a famous terrorist case

ALTHOUGH Magna Carta expressly forbids it, torture has often been a part of judicial procedures in England. Under the Tudors and early Stuarts, its use increased. No rules governed it, other than the pity or discretion of the torturer. But it was understood to be justified especially in treason cases, and where time was of the essence.

Perhaps its most famous use in English history was to extract confessions from those involved in the Gunpowder Plot, the conspiracy in 1605 to blow up Parliament. Yet the extent of the torture applied was so far concealed at the time (guilt and distaste, even then, playing their part) that it is often unclear how much a plotter was made to endure. The best evidence remains the fact that something made defiant men talk.

Guy Fawkes, the most famous conspirator—a Catholic zealot who had fought in “holy wars” abroad—was “examined” by William Wade, the lieutenant of the Tower of London, from November 6th onwards. King James I had asked Wade to use “the gentler Tortures” first. These included thumbscrews and manicles, by which a man was hung up by his wrists. On the 7th, Fawkes weakened so far as to admit his own name. He would not admit the names of his accomplices.

On the 9th, still showing “a most stubborn perverse humour”, he was sent to the rack. One royal official said that “Fawkes was never on the rack, but only by his arms upright”. (The mere sight of the machine, on which the rackmaster slowly stretched legs and arms to the point of dislocation, was often enough to elicit confessions.) Others said he was “extremely racked”. His signature, weaker and more wavering as he signed successive statements, suggests this was the case. Certainly, he started giving names.

The most important was that of John Gerard, a Jesuit priest. With this name, Wade could prove that the Society of Jesus was the brains behind the plot, and appropriate pressure could be applied to the chief Jesuit suspect, Father Henry Garnet. Yet the plot was not, in fact, a Jesuit conspiracy. On the contrary, their role was marginal. Torture had led Fawkes to produce a name that fed the false or wilful assumptions of the English government, but did not point to the truth.

Torture had also led Fawkes, a fanatic, to betray the cause to which he had devoted his life. Another lesson of his case is that even a man of the fiercest convictions, who knows without doubt that he is going to be executed, can be made to reveal information once the torturer gets to work. Hence the lasting appeal of it, even for authorities who think themselves enlightened.

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Truth serums

False hopes

Jan 9th 2003
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Drugs cannot make you tell the truth

SIMPLE solutions to complex problems rarely succeed. Few problems today are thornier than trying to prevent terrorist acts. So pundits, in publications as various as the *Atlantic Monthly*, *Newsweek* and the *Wall Street Journal*, have been calling for the use of “truth serum” for interrogation of suspected terrorists. Alas, no such drugs are known to work.

Sodium pentothal, the trade name for thiopental, is the best-known of a class of barbiturates popularly supposed to act as truth serums. These drugs, commonly used in larger doses as anaesthetics, are thought to work by enhancing the brain's sensitivity to a depressant neurotransmitter known as GABA that is naturally present there. James Cottrell, the president of the American Society of Anaesthesiologists, says that although thiopental sometimes makes people talk more, it does nothing to ensure that what they say is truthful. Dr Cottrell does not believe that thiopental has any long-term adverse affects, though Vincent Iacopino, acting director of research for Physicians for Human Rights, an American charity, cautions that it can be addictive.

Dr Iacopino says that drugs have been used in questioning to disorient prisoners, or to instil fear, but he does not know of any drugs that can force the truth to come out. Nonetheless, governments have certainly tried. Most recently, the Indian government is reported to have administered thiopental last June to seven Muslims suspected of causing the Gujarat train fire.

The legality of such methods of interrogation is less clear than their efficacy. A 1963 Supreme Court decision makes evidence obtained from drugged suspects inadmissible in American courts, and drugs cannot be used on prisoners-of-war under the 1950 Geneva Convention. However, the Convention Against Torture is less clear on the matter, and America's CIA and Pentagon refuse to say whether they use such drugs.

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Tax cuts: the sequel

Climb on, honey: this could be wild

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George Bush's tax-cut plans are not for the faint-hearted

IN TERMS of foreign policy, George Bush showed his ambition long ago. This week he proved to be no shrinking violet on the domestic scene. On January 7th, the first day of the new Republican-led Congress, he proposed an economic plan far bolder than anyone expected. In order to increase the "momentum" of the recovery, Mr Bush asked Congress to pass tax cuts worth $670 billion over the next ten years—half as big as his whopping 2001 tax cut and twice the sum his advisers hinted at the previous week.

The plan has three goals: to encourage consumer spending, boost investment and help the unemployed. Is it a "stimulus package"? Well, Mr Bush was very careful not to use that term. White House economists stress the way the plan will buttress strong economic growth in the future and improve the overall tax code. On the other hand, his proposal goes under the somewhat stimulating title of "a growth and jobs plan". And in his speech Mr Bush claimed that "urgent" action was necessary and gave top billing to boosting consumer spending.

To that effect, the White House wants to speed up many of the tax cuts that the 2001 package phased in over the next few years (see table). The reductions in marginal income-tax rates already slated for 2004 and 2006 are to be brought forward to January 2003. The highest marginal tax rate, for instance, will fall immediately from the current 38.6% to 35%. Rather than being phased in gradually by 2010, the child tax-credit will be raised from $600 to $1,000 per child immediately. The marriage-tax penalty—the quirk of the tax code that makes some married couples pay more than singles living together—will be reduced now, not by 2009. And the lowest 10% tax bracket will be broadened to include more people. Altogether, Mr Bush claimed, these tax cuts will help 92m people and pump $70 billion into the economy over the next 18 months.

But the bulk of the tax cut—some $364 billion over the next decade—is devoted to a reform mostly aimed at boosting investment: eliminating the double taxation of dividends. Currently, much corporate income is taxed twice: first when a firm makes a profit, and second when investors receive their dividends. Describing America as "a nation of owners", Mr Bush announced it was time to treat investors fairly. This should boost the stock market (and so, indirectly, boost consumer spending), encourage investment and improve corporate governance (see article).

By contrast, Mr Bush's efforts to help boost business investment directly were more modest. He wants to raise the amount of equipment spending that small businesses can deduct as an expense to $75,000. But, despite considerable corporate lobbying, there is no broadening of investment incentives for big firms. Longer-term reform takes priority, it seems, to short-term corporate hand-outs.

Your second course

Tax-cut effects of the "growth and jobs" proposal
$bn

	2003*	Over ten years
Accelerate all income-tax rate cuts to 2003	29	64
Exclude 100% of dividends from taxation at the individual level	20	364
Accelerate marriage-penalty relief to 2003	19	58
Accelerate child tax-credit increase to 2003	16	91
Accelerate expansion of 10% income-tax bracket	5	48
Increase small business expensing limits to $75,000	2	16
Adjust Alternative Minimum Tax	8	29
Total	98	670

Source: US Treasury *January 1st-December 31st

The third bit of the plan—help for the unemployed—was modest but innovative. Mr Bush has just signed a bill to extend federal unemployment-insurance benefits, which expired for about 800,000 workers on December 28th. The new twist is to spend $3.6 billion via the states to create new "personal re-employment accounts" of up to $3,000 for people who have trouble finding a job. Such schemes should make government support more flexible and spur the incentives for the unemployed to find work quickly.

Add all these proposals together and what do you get, beyond a $670 billion price tag? In Washington, the answer, predictably, depends on whom you talk to. The conservative faithful are happy. This is just the kind of tax-cutting, pro-growth agenda that the *Wall Street Journal* and the Club for Growth want. Reducing marginal tax rates has always been a priority; and they hope the elimination of dividend taxation will lead to fundamental tax reform.

By contrast, Joe Lieberman, a probable Democratic presidential hopeful, called the plan "an irresponsible, ineffective, ideologically-driven wish-list". Democrats moan about three things: the scheme is just a give-away for the rich; the tax-cuts will do little to stimulate the economy now; and it is all too expensive.

Reaganism returns

For all Mr Bush's talk about helping middle-income Americans, the benefits of these tax cuts accrue mainly to the rich. According to an analysis by the Urban Institute and the Brookings Institution, the richest 10% of Americans would get 59% of the tax cut, while the bottom 60% of Americans would get 8%. Eliminating the dividend tax, in particular, largely helps the wealthy. Mr Bush said, rightly, that half of all dividend income goes to older Americans. What he did not say was that it goes mainly to rich older Americans.

Since richer Americans pay most taxes, nobody should be too surprised about this. But this line of attack clearly worries the White House. Even before his speech, Mr Bush was trying to deflect Democrat jabs. Class warfare, he said, was "not how I think". Instead, he thought "about the overall economy and how best to help those folks who are looking for work".

This may not be a wise defence, because, when it comes to creating jobs now, the Democrat critique seems still more apt. Even by the Bush team's own numbers, this is not an efficient short-term stimulus package: it pumps only around $100 billion of the tax cuts into the economy over the next year. And most of the money goes to richer Americans, whom economists reckon are less likely to spend the additional cash than poorer ones.

Led by Nancy Pelosi, House Democrats proposed a $136 billion plan even before Mr Bush's speech. Billed as a "fair, fast-acting and fiscally sound" stimulus, the Democrats' plan includes a $300 one-time tax rebate for all working Americans; short-term investment incentives for large and small businesses; and $31 billion of financial assistance for the states, as well as the extension of unemployment insurance. Virtually all of this (much cheaper) fiscal push would boost the economy this year.

Mr Bush can still argue correctly that his plan is not primarily about a short-term stimulus; his real goal is much broader pro-growth tax reform. But that still leaves the third Democrat attack: that Mr Bush's plan is too expensive.

Using the latest estimates from the Congressional Budget Office, which themselves are based on improbably tight spending, Mr Bush's tax plan would pretty much obliterate what is left of any budget surpluses over the next decade. And the ongoing cost of eliminating dividend taxation (perhaps $50 billion a year) worsens the budget outlook thereafter, just as retiring baby boomers place huge burdens

on the government's finances. Nor is this likely to be the last tax cut. After 2006, for instance, huge numbers of Americans will be hit by the Alternative Minimum Tax, something that no politician will allow to happen. For all these reasons Democrats accuse Mr Bush of busting the budget, with the consequence of higher interest rates and slower economic growth.

The White House replies that the cost of the tax cuts is likely to be smaller than many now expect, as economic growth rises in response to better incentives. One Treasury analysis suggests that once these dynamic effects are taken into account, the five-year cost of the tax cut falls from $359 billion to $166 billion. Mr Bush's people also dispute what they call “Rubinomics”: the notion that bigger budget deficits fuel higher interest rates.

This all sounds distinctly like the 1980s. This is not a mere short-term stimulus package, but an ambitious Reaganesque attempt to grasp the political moment to push through a broader tax agenda. The White House is aiming for speedy passage, preferably by April 15th, not just to make sure that the economy sees a boost before the 2004 election, but also to move on swiftly to equally ambitious reforms in Medicare and, later, in Social Security.

Will Congress play ball? The House Republicans have already come out in favour of the plan. But several Republican senators are nervous. John McCain and Lincoln Chaffee, for instance, have already criticised parts of the plan. Democrats are shouting loudly and putting forward their own priorities. No one in the White House expects Mr Bush's plan to pass unscathed. But with such a brassy opening gambit, he has at the very least given himself a lot of bargaining chips.

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Arkansas culture

No nudes is good news

Jan 9th 2003 | LITTLE ROCK
From The Economist print edition

Fancy some fruit instead?

ARKANSAS calls itself the Natural State: but don't take that literally. At the opening of the 84th general assembly next week, state legislators won't be eyeing any traditional nude drawings in the state capitol. After a recent $2m renovation of the Senate chambers in the capitol, officials decided to accentuate the creative by displaying paintings by Arkansas artists. But with one stipulation: no cleavages, curves or rude bits.

Artists like Little Rock's Kevin Kresse, who numbers many nudes among his portraits, are frustrated that the legislators want no more than chaste landscapes and bowls of fruit. He complains that art displays and bigger projects—for example, a new civil-rights sculpture in the capitol grounds—are seldom opened up to all artists. Instead, decisions on who can display, or who gets commissions, are made behind closed doors and announced later.

Not true, say the lobbyists and art-collectors who make up the committee that decides these things. In the case of this first show, which features about 40 paintings, there was simply no time for a jury judging. The committee just came up with a list of artists who had fine reputations in the line of traditional, representational stuff.

Banning nudes does seem to be a conservative thing. Last year, John Ashcroft, the federal attorney-general (who hails from neighbouring Missouri, the alleged “Show Me State”), demanded covering for the naked breast of a statue at the Justice Department, after it had upstaged him at a serious press conference. The cost of rendering the pert goddess a decent sight for Mr Ashcroft's eyes: $8,000.

But fear not: in Little Rock, at any rate, puritanism never gets much further than the eye of the beholder. It is a rare Arkansas legislator who hasn't seen a real naked body, or several, during his or her political career (even if you exclude Bill Clinton—and not many did). It is political legend in Little Rock that liaisons have occurred in many a nook and cranny of the marble capitol building, which just happens to be a replica of the one in Washington, DC.

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Immigration

Our kinda ciudad

Jan 9th 2003 | CHICAGO AND MINNEAPOLIS
From The Economist print edition

Why are so many Mexicans heading for the mid-west?

IF you think the mid-west is too cold and white for Latino culture, take a stroll down 26th Street in Chicago's Little Village. Two miles of shops are flush with goods from Mexico: cowboy hats, snakeskin boots, and the flouncy white dresses that teenage girls wear for their *quinceañera* parties. An old man from Michoacán, peddling mango and papaya from his pushcart in the freezing weather, says he arrived 21 years ago and still doesn't speak English. No need, he adds, in *la Villita*.

Altogether the seven main mid-western states are now home to 9% of the Mexicans living in America, up from 7% in 1990 (see chart). Having overtaken San Antonio, Chicago now has the second-biggest Mexican population in America, behind only Los Angeles and well ahead of places like Houston. The number of Mexicans in the Windy City rose by 50% during the 1990s to reach 530,000 in 2000, according to the census. Twice that number live in Illinois.

This trend has been repeated in other less urban mid-western states. Mexican populations more than doubled in Minnesota, Iowa, Indiana and Wisconsin during the 1990s. In St James, an agricultural town of 4,695 people in south-west Minnesota, nearly one-quarter of the population is Latino (largely Mexican). In a string of towns running south from Minneapolis to the Iowa border, some of the country's largest meat-packing operations are kept going principally by employing Mexicans, sometimes in appalling conditions. In October, the remains of 11 undocumented Mexicans were found inside a locked box-car near Des Moines, Iowa.

The mid-west, with its cold winters, distance from home and lack of historical ties, seems an odd choice for Mexicans. Why do they come? A few have been there for a long time. In the early 20th century, Mexicans were brought in to work on railway lines, to tend sugar-beet fields or even as “scab” steelworkers during strikes; some stayed and founded communities like *la Villita*. Every year, migrant farmworkers added to the numbers during harvest time.

The recent wave of immigration is partly driven by economic opportunism: the mid-west offered more diverse and better-paid jobs than the south-west. But it has also been caused by measures to keep immigrants out. Sterner border controls in the 1990s made it harder for Mexicans to move back and forth easily, prompting many migrants to settle—and bring their families. The controls also meant that there was less incentive to live near the border and more incentive to find well-paid jobs wherever they existed. September 11th has only tightened things further; it also seems to have dampened hopes of a formal guest-worker programme.

These new arrivals have an enormous economic effect. Elizabeth Handlin, an official with the Federal Reserve Bank of Chicago, says about $9.2 billion in remittances were sent from America to Mexico in 2001. Many of the mid-west's agribusinesses, factories, hotels and restaurants rely heavily on Mexican labour. A 2000 study by HACER, a Latino advocacy group, estimated that undocumented workers (most of them Mexican) added $1.5 billion to Minnesota's gross state product and contributed more than $1 billion in state tax revenue. “The meatpacking businesses in south-east Minnesota would have to close up shop without them,” claims James Kielkopf, author of the report.

Identity cards, sort of

The Mexican government, trying to come to terms with the fact that about a tenth of its population lives in America, is now trying to formalise its relationship with these exiles. These moves seem to have gone further in Chicago than elsewhere, partly due to an unusually energetic consul-general, Carlos Sada, a former mayor of the Mexican town of Oaxaca.

In Chicago the number of local “Mexican clubs”, which funnel money back to specific towns in Mexico to build schools, roads and churches, jumped from 35 in 1995 to 181 last year. Every morning hordes of Mexicans cram into the consulate seeking a *matrícula consular*—an identity card that allow them to open bank accounts and which is recognised by the city, regardless of the holder's legal status (the consulate doesn't ask). The Chicago consulate now issues about 1,200 cards per day, triple the rate of a year ago (and, it adds proudly, well ahead of the rate in LA).

This is not just a tribute to Mr Sada's enthusiasm. Jorge Santibáñez, president of El Colegio de la Frontera Norte in Tijuana, Mexico, argues that geography also forces the mid-west's Mexicans to be more organised. Over time, he predicts, a split will open up in America's Mexican communities: those in Los Angeles and Texas will become ever more like Mexico, but the more isolated northern Mexicans around Chicago will integrate better.

That does not mean that they will do particularly well—as the wretched Mexicans in the box-car proved. Mexicans in the mid-west are typically poorer and less educated than other immigrants, and many worry they will become a permanent underclass. In Minneapolis a Latino group known as CLUES runs a distance-learning centre, set up with help from both the Mexican government and the state of Minnesota, that allows immigrants to follow a Mexican curriculum for high-school before testing for an American diploma.

Such collaborative efforts, argues Mr Santibáñez, show a change of emphasis. Rather than trying to forge great treaties with the federal government over things like guest workers, the accent now is on smaller bottom-up schemes, involving the states and communities like 26th Street.

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Water policy in the west

Pipe dreams

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Southern California must curb its thirst faster than it thought

MARK TWAIN lived only three years in California, but he bequeathed the young state a handful of enduring mottoes. None has lasted better than his observation that, out west, “whiskey is for drinking; water is for fighting over.” Perhaps Chardonnay has sapped California's spirit, because the state that built itself by grabbing other people's water has started this year by foolishly giving some up.

The battle surrounds the Colorado river, which runs along California's border with Arizona and supplies half of Los Angeles's water. Seven states have claims on the Colorado under a law passed in 1928. Back then, only California among them had much population, so the booming state happily swallowed not only its share, but also most of the “surplus” water not allocated in the treaty. Now the other states include some of the fastest-growing cities in America. Greater Phoenix, in Arizona, grew from 332,000 in 1950 to 3m in 2000, and Clark County, Nevada, which includes Las Vegas, grew from 48,000 to 1.4m. These thirsty youngsters want “their” water back.

In 1999, the federal secretary of the interior decreed that California had to cut its use of water from the Colorado from its current 5.2m acre-feet (6.4 trillion litres) to its legal allocation of 4.4m acre-feet a year. He gave the state three years to work out a plan for reducing consumption, and then until 2015 to phase it in. If California could not come up with a plan, the department would simply cut off its share of the surplus abruptly. The deadline passed at midnight on December 31st without a plan, so the department has turned off the tap.

The cut is steep, but not devastating. Southern California's Metropolitan Water District, which serves 17m people, will lose a quarter of its total supply, but its reservoirs have two years' supply to buffer the shock. It will speed up existing plans to build desalination plants and cut consumption. Gardens absorb half of all residential water supplies in southern California. Rene Russo, a Hollywood actress, is leading a campaign to promote hardy native shrubs in place of lawns, and the district will subsidise high-tech sprinklers. There is even some hope that nature could help in the short term: heavy snow has fallen in the Sierra Nevadas, building up the supply for next year.

Yet with the longer-term fears throughout the west still concentrated on drought, it would have been better for California to have spun the process out for another decade. What on earth has happened to the Machiavellian water-rustlers Jack Nicholson chased down in “Chinatown”?

The sticking-point that prevented a deal was a familiar one: strife between cities and farms. Ludicrously, farmers, who account for only 3% of California's economy, use about 80% of its “developed” water. True to this picture, about three-quarters of California's Colorado river water goes to the Imperial Valley, a former desert inland from San Diego that now supports 500,000 acres of fruit and vegetables.

Cutting overall use will require reallocating some of the farm water to the cities. In October, several regional water authorities suggested a plan for Imperial County's water board to sell up to 200,000 acre-feet a year—enough to supply 400,000 households—to San Diego. But the Imperial board rejected it. Its

main worry is keeping up the amount of water that runs off its fields into the nearby Salton Sea. If the level falls, the concentration of agricultural chemicals in the water is likely to rise, potentially poisoning the migrating birds that stop there. Late on December 31st, the Imperial board proposed a revised plan with extra clauses protecting farmers against environmental lawsuits and the cost of cleaning up the lake. The other authorities did not have enough time to study it, and the deadline passed.

The water boards still hope to strike a deal and persuade the Department of the Interior to relent. But a more startling possibility exists. Agriculture's political clout has waned. Although the Central and Imperial Valleys have amazingly productive soil, other countries can produce crops much more cheaply. In particular, low-cost farmers in China, now a member of the World Trade Organisation, are a threat. Even with transport costs and a 376% tariff, Chinese garlic is cheaper at a wholesaler in Oakland than that from nearby Gilroy, the “garlic capital of the world”.

Prices are falling for most crops, dropping closer to the point at which California can no longer compete with poorer countries. In 2001, sales of Californian prunes, pistachios and cotton all dropped by a third. Sales of broccoli and fresh plums were down by 24%, of tomatoes and lettuce by 22%. California farmers may soon find that there is more money in selling their water rights than in using them to raise crops. No doubt they will still fight about the price.

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Lexington

Democratic hopefuls

Jan 9th 2003
From The Economist print edition

Not quite the oxymoron you might think

GEORGE BUSH bestrides the American political world like a colossus: the most powerful president since Ronald Reagan. The Republicans have majorities in both houses of Congress. Mr Bush's poll ratings haven't fallen below 60% since September 11th. Even his disasters turn into triumphs: look at the way the White House replaced Trent Lott, the self-outed segregationist, with the more sympathetic Bill Frist as Senate leader.

You would think that the Democratic Party would have to press-gang people into taking on Mr Bush in 2004. Running for the presidency is a ghastly job at the best of times (unless you happen to fancy spending two years sleeping in identikit hotels, eating high-cholesterol food and chatting up obese bores, whilst the press waits to trip you up the moment you say something truthful). Running for the office against a popular president and the most ruthless hatchet-man in American politics, Karl Rove, is most people's definition of hell.

But no. Democrats are queuing up to do battle with Messrs Bush and Rove. Hardly a week goes by without a Democrat declaring that he wants to run for the presidency. Last week it was John Edwards. This week it is Richard Gephardt. John Kerry and Howard Dean are already running hard, along with a newly-slim Al Sharpton. Joe Lieberman looks sure to throw his hat into the ring. Bob Graham is keen. Even Gary Hart, now adorned with an Oxford University doctorate, is thinking about running. The only two drop-outs, after a great deal of public soul-searching, have been Al Gore and Tom Daschle, who oversaw their party's loss of the White House and the Senate respectively.

Mr Sharpton aside, the Democratic field will be as impressive as it has been for years. Mr Gephardt led the party in the House. Mr Kerry is a Vietnam veteran and foreign-policy wonk. Mr Edwards is the party's golden boy, a southern moderate from humble beginnings. Mr Lieberman, already a veteran of one presidential campaign, is the standard-bearer of the pro-business wing of the party. Mr Dean, the outgoing governor of Vermont, may look like a typical no-hoper, but he has interesting ideas on health care.

The Democrats may also be right that the colossus has feet of clay. During the 2000 presidential campaign, Mr Gore chided Mr Bush for his fondness for “risky schemes”. Look at the economy. Mr Bush's

enthusiasm for cutting taxes while increasing spending can only lead to ballooning deficits. Add to this the fact that the stockmarkets have lost several trillion dollars since Mr Bush took office, and he hardly looks like a steady hand. Or look at the looming war with Iraq. Mr Bush's critics could not get it more wrong when they charge him with exploiting Iraq for domestic reasons; in fact, the easiest way to secure his popularity would have been to ignore Iraq and concentrate on al-Qaeda. If Mr Bush is right, and Iraq possesses weapons of mass destruction, then America risks huge casualties; if he is wrong, and Pandora's box is empty, then he risks looking like a fool.

What about last November's excited talk about Mr Bush breaking the 50-50 stalemate that has haunted American politics for a decade? More and more people are having second thoughts. Mr Bush may have succeeded in galvanising his base, those troops that came out to vote in unprecedented numbers two months ago. But he is not making huge progress among floating voters. The Republicans failed to unseat Mary Landrieu in Louisiana despite a gigantic effort. Mr Bush's poll numbers have been drifting steadily downward for the past year.

Be tough on terror—and the undeserving rich

So there is an opportunity here—or at least the whiff of one. But how do you turn a lurking opportunity into electoral gold? Not by vagueness and waffle, that's for sure. If the mid-term elections proved anything, it was that the Democrats are doomed unless they can produce a coherent message. The good news for them is that such a message is not beyond the wit of man. The bad news is that it requires political skill.

The Democrats are doomed unless they can start contributing to the national debate on terrorism. Forget about offering bland approval of Mr Bush's aims while nitpicking about means. Forget about trying to change the subject to pills for pensioners. And forget about trying to appease the nitwits who think Mr Bush is more of a threat than Saddam Hussein. Instead, criticise Mr Bush for doing too little, not too much.

Why isn't he doing more to rebuild Afghanistan? Why isn't he doing more to redesign the CIA and the FBI? Why did he let proven incompetents like George Tenet stay as the head of the CIA? The Democratic field will be massively improved if Mr Lieberman adds his name to the list: this is a man who is so sound on national defence that his Senate office telephone system plays military marches to callers on hold. It would be improved even more if Florida's Senator Graham signed up. Mr Graham is not only a hawk on terrorism; he hails from a vital swing state and, as a former governor, possesses something that is in short supply in the current field, executive experience.

A tough terrorism policy would make it easier for the Democrats to play their strongest card at home: America's growing inequality. This was the card that Mr Gore played spectacularly badly in 2000, but it could still work. Inequality has risen to levels not seen since the Gilded Age and the 1920s, eras that were both followed by anti-business backlashes. Inequality threatens the fundamental American principle of equality of opportunity—and policies like Mr Bush's tax plan could easily (though a little perniciously) be spun as sops to the rich.

Can the Democrats rally Americans against economic elitism without raising the spectre of class war? And can they get tough on terrorism without alienating their own left wing? The odds are surely against them. But it is worth a shot.

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Argentina's economy

Storm abated, outlook still unsettled

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From The Economist print edition

AP

Can much swallowing of IMF pride make an Argentine economic summer?

IN BUENOS AIRES they call it the *veranito*, or Indian summer, meaning that it may not last. But a year after Argentina's dramatic default and devaluation, and long after most economists had expected the place to plummet into hyperinflation, there are ever more signs that the economy is over the worst. Output has stopped falling. According to official figures, industrial production rose in the year to November, for the first time in 27 months. The exchange rate, stable at 3.5 pesos to the dollar since July, recently strengthened. Unemployment has fallen (albeit from 22% to 18%) and consumer confidence is rising. And a much-delayed agreement with the IMF seems to be in the bag at last.

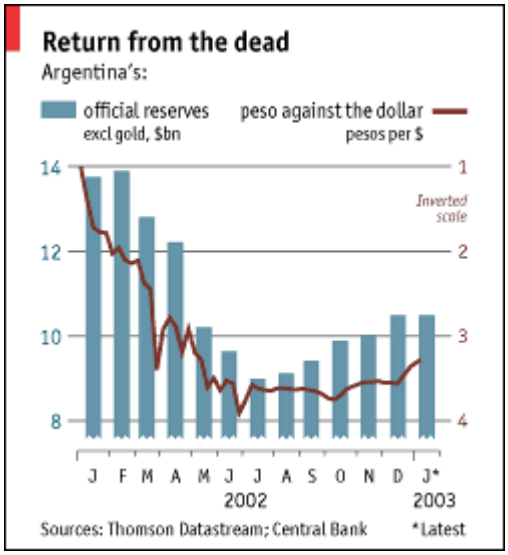
For much of the past year, President Eduardo Duhalde's government has held protracted talks with the Fund over a new loan programme. The IMF took a tough stance. It was sceptical about Mr Duhalde's ability to stabilise the economy, let alone reform it. Now, it seems, the Fund has been forced by its political masters—specifically the G7 group of rich countries—to cave in. France and Italy led the charge for leniency, and were recently joined by the United States.

The G7's plan is for a pared-down “transition” loan that would last for six months (until after a presidential election, currently scheduled for April 27th). There would be no new money; the Fund would merely lend enough to ensure that Argentina does not default on its debts to the IMF itself. But the plan involves no new meaningful reforms. From utility prices (where it was demanding a big hike) to the issue of *amparos* (court-ordered repayments of individuals' frozen savings, which it wanted stopped), the IMF looks about to back down. Barring last-minute changes, the Fund's board is due to approve an agreement in these terms on January 17th—precisely the day that Argentina is due to repay the IMF $1 billion, a payment that the government had threatened not to make.

Whatever its implications for the IMF, for Mr Duhalde a loan agreement would be a big coup. It would vindicate his strategy of putting pressure on the international institutions by threatening to default on Argentina's debts to them. (In November, the government defaulted on $800m of World Bank debt. Without an IMF agreement, further defaults are likely). More important, an agreement would provide a seal of approval for the government's economic strategy, and its view that the economy is on the mend. Roberto Lavagna, the economy minister, recently declared that the country's four-year recession is over. This was not just an Indian summer, he implied, but the dawn of serious recovery.

Unfortunately, such optimism may be misplaced. Yes, the

economy has stopped collapsing—at least for now. The government has been more adept at creating stability than many had expected. Argentina has had many big devaluations in its turbulent history. They have generally been followed by hyperinflation. Not this time: although the peso fell by 70% last year, consumer prices rose by only 40%. That was mainly because devaluation took place in a deeply depressed economy with high unemployment. But the government's policies have also been better than many expected. It did not resort to the printing presses to satisfy populist spending pressures. In nominal terms, public spending stayed constant, meaning that it fell sharply in real terms.



After some disastrous early decisions, such as freezing deposits, and converting loans and deposits from dollars to pesos at different rates, monetary policy was also surprisingly skilful last year. The central bank steered a careful course between providing liquidity for banks whose deposits were fleeing, and keeping the exchange rate stable. Gradually, public confidence in the peso returned. As one economist quips: "Argentines are now more worried about burglars at home than about banks ripping them off." At the same time, strict capital controls mean that firms, at least in the short term, have had little choice but to put their export earnings in banks. The result is that demand for pesos is rising, so much so that restrictions on frozen current accounts were lifted in December and those on time deposits were loosened.

How long might this fragile stability last? A relatively cheerful Wall Street banker sees the *veranito* stretching until the election. "The notion that there is something unsustainable in the Argentine policy framework is a bunch of rubbish," he says. Some Argentine economists agree.

But many are worried. In passing the budget last month, Congress weakened the government's grip on spending, and pressure to spend will rise as the election approaches. In principle, an IMF agreement should help the government hold the line—but this one may not. An agreement might in turn embolden Mr Duhalde to postpone the election, or try to stand again himself. Such political uncertainties could result in a renewed loss of confidence in the peso. That could trigger a bank run, particularly when the remaining deposit controls are lifted.

Even more worryingly, Argentina's current policies do not grapple with its core problems—a bankrupt state and an insolvent financial system. The *veranito* rests on financial controls, autarchy and a very weak exchange rate. Argentina has no access to outside financing (not even trade finance). It ought to be poised for an export-led boom: it has a hugely competitive exchange rate, good infrastructure and has had a decade of high investment in plant and machinery. But strong growth in exports is impossible without credit. Banks will not lend again until their balance sheets are restructured and the legal uncertainties surrounding frozen deposits and loan repayments are reduced.

An IMF agreement would be a small step towards ending Argentina's financial isolation, but the government still has to renegotiate its debt (of about $100 billion) to private creditors. Even if they accept a huge write-down on their loans, servicing these will require a budget surplus (before interest payments) far bigger than this year's target of 2.5%. Given this to-do list, it is a little too soon to declare that the worst is over for Argentina.

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Brazil's new era

Picking losers

Jan 9th 2003 | SÃO PAULO
From The Economist print edition

A good start for Lula

Get article background

A BIG part of the work of Brazil's new president, Luiz Inácio Lula da Silva, will be picking winners and losers in his quest to make Brazilian society more equal. A week into the job, he seems to be choosing his targets well. The losers, Lula is making ever clearer, are going to be the beneficiaries of a state that collects a third of GDP in taxes without doing much to lessen inequality. The winners, if Lula plays his hand well, will be Brazil's poor—and, ironically, the financial markets.

Among the first victims are the armed forces: Lula put off for a year the purchase of a dozen fighter planes, which would have cost $700m. All ministries have been ordered to submit most of their discretionary spending to the finance and planning ministers for approval, the sort of thing the president used to abominate when he was a fiery left-wing opposition leader.

More important in the long run are signs that Lula may soon tackle the biggest welfare programme for the better-off, pensions for government servants, which generate a deficit of more than 4% of GDP. Reform will be introduced before July, said André Singer, Lula's spokesman. Opposition parties claim that they will not block this in Congress, where Lula's nine-party coalition is in a minority. But its passage will be a battle.

Part of the savings will be used to repair the battered public finances. There is speculation that the government will soon announce a more ambitious target for its budget surplus (before interest payments) of more than 4% of GDP, rather than 3¾%. Investors, who had once regarded Lula as a spendthrift potential defaulter, are ebullient. This week, the *real* reached its highest level since mid-September. Foreign investment is returning to Brazil's stockmarket.

All this smacks of continuing the previous government's policies. Lula means to make his mark by putting some of the money he saves into new programmes to alleviate poverty, though their design is not yet clear. His first anti-poverty venture has encountered a slight, but perhaps symbolic, glitch. The president, rightly worried that his ministers will soon forget the poor, had planned to take his entire cabinet on a field trip to Guaribas in the north-east, one of Brazil's poorest municipalities. The itinerary has now been modified. Getting to Guaribas, Lula's spokesman explained, would cost too much.

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Politics in Mexico

Evolutionary struggles

Jan 9th 2003 | MEXICO CITY
From The Economist print edition

An electoral year will provide a test for Mexico's former ruling party

Get article background

EVERY political party is always on the look-out for the youth vote. But few go to the lengths of Mexico's formerly ruling Institutional Revolutionary Party (PRI). To attract spotty youngsters, it has selected one as its candidate for an election in March for mayor of Naucalpan, a sprawling suburb of Mexico City. César Gómez, aged 20, looks every bit as young and inexperienced as he really is. Not only is he a first-time candidate, he is a first-time voter.

The PRI, which governed Mexico for 71 years until its traumatic defeat by Vicente Fox in the presidential election of 2000, is desperate to reinvent itself. Hence Mr Gómez. His opponents scoff that his selection is just a gimmick. But PRI officials point out that the average Mexican is aged just 23. Mr Fox's National Action Party (PAN) scooped much of the youth vote in 2000. So the PRI has decided that 30% of its candidates should be under 30 (and in theory, at least, half should be women).

This year will be the test of those efforts: July sees a mid-term election for Mexico's Congress which will make or break Mr Fox's presidency and shape the country's politics for the next three years.

Not everyone in the PRI is happy with change: not for nothing are its traditionalist leaders dubbed “dinosaurs”. But the new candidates do represent an effort to adapt to a changed society. Will this be successful? The PRI retains strengths: it runs 19 out of Mexico's 32 states, is the largest party in Congress, and still controls many trade unions and farmers' groups. But the party's efforts at modernisation are handicapped, perhaps fatally, by two big disadvantages, both legacies of decades of undemocratic one-party rule. The first problem, points out José Antonio Crespo, a political scientist at CIDE, a Mexico City university, is that “voters link the PRI intimately with corruption”. On that issue, the party has done little to break with its past. Indeed, Roberto Madrazo, elected as the PRI's president last year, while a wily political operator, is also a powerful symbol of that past: in 1994, he became governor of Tabasco state in a notoriously murky poll. True to form, his narrow victory in the PRI's leadership vote was mired by a row over ballot-rigging.

The PRI saw in the new year with disputed primary elections in two states. The party has also been dogged by an allegation that $170m from the national oil company was fed through the oil workers' union to fund the PRI's presidential campaign in 2000. Mr Madrazo initially stood by the accused union officials, who are also PRI deputies, until the party's poll ratings plunged.

The PRI's second big problem is that it is “incapable” of entering into policy discussions, as Enrique de la Madrid, one of its younger congressmen, puts it. Without the presidency, the party's old top-down decision-making process has gone; it is struggling to develop democratic mechanisms to replace this. So the PRI has been unable to set out clear, agreed, positions on such basic policy questions as the reform of the state-run electricity industry. The upshot is that the PRI has been unable to cash in on Mr Fox's declining popularity. Polls show that it is stuck some 5-10% behind the PAN. The challenge continues to be “to transform the PRI from the Ministry of Electoral Affairs into a political party,” says Mr de la Madrid.

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Politics in Peru

Military mutters

Jan 9th 2003 | LIMA
From The Economist print edition

The grievances of a humbled army

Get article background

Reuters

The court leaves Guzmán's cage ajar

THE retired admiral is seething: “I don't know when we went from being acclaimed as national heroes to being in the dock.” Peru's armed forces were once hailed for having crushed terrorism. The downfall of Alberto Fujimori, the president from 1990-2000, laid bare their involvement in huge kickbacks on arms purchases, in human-rights abuses and even electoral fraud. But now the army reckons the pendulum has swung too far.

After Mr Fujimori's fall, a caretaker government purged the high command and officers linked to Vladimiro Montesinos, his intelligence chief. A dozen generals are in jail, facing corruption charges. Alejandro Toledo, who was elected president in 2001, wants to bring the armed forces under tight civilian control. His government aims to slim the officer corps, and make it more professional and accountable (the auditor-general would check the military books). But reform is stirring up unrest.

In December, in what his military critics called a “sadistic” vendetta, the defence minister sent 420 officers into retirement. That is more than usual, but needed (and will be each year until 2006) to give a top-heavy force a conventional pyramid profile. The defence budget has been slashed too, by almost 20%. By the end of last year, soldiers were being sent home at weekends for lack of rations, and money for maintenance had run out. The government responded with one-off payments to plug the gap, and authorised the selling of redundant defence-ministry properties.

Mr Toledo has also opened the door to the reckoning the armed forces never faced under Mr Fujimori for abuses in the crushing of terrorism in the 1980s and 1990s. A Truth Commission is looking at thousands of “disappearances”, and prosecutors are investigating several cases where soldiers executed guerrilla prisoners. Last week, in a controversial ruling, Peru's Supreme Court struck down some provisions of Mr Fujimori's anti-terrorist law. This will allow around 800 prisoners from the Shining Path terrorist group, including Abimael Guzmán, its notorious leader, who were convicted in military tribunals to demand retrials by civilian courts. But they will remain in jail meanwhile.

Ordinary Peruvians still see Mr Fujimori's crushing of terrorism as a triumph, and do not quibble about the methods used. Faced with a public outcry when commandos who had rescued 71 hostages after a siege at the Japanese ambassador's residence in 1997 were accused of executing their rebel captors in cold blood, Mr Toledo's government was happy to see the case sent to a military court.

Supporters of Mr Fujimori accuse the government of being soft on terrorism while neglecting the army. Certainly, Shining Path's tiny rump stirred into life last year, but mainly with peaceful propagandising. There are reports, too, of incursions by FARC guerrillas from Colombia. The government has ordered the army to set up five new bases in hot spots. But grumbling of cash shortages, and disgruntled by the digging up of the past, commanders have been reluctant to patrol. Such grievances are real. But so is Peru's need to cut an overmighty army down to size.

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Sport in Canada

Rink rage

Jan 9th 2003 | MONTREAL
From The Economist print edition

Fear and lawsuits on the ice

CANADIANS like to say that their national religion is ice hockey. The sport bridges English- and French-speakers, native and non-native, east and west—and marks national identity by helping to distinguish them all from Americans. Such is its importance that John Manley, the finance minister, had no qualms about lobbying a bank last week to help out a cash-strapped professional team—and suffered little criticism for doing so.

Not long ago, hockey was said to be “in crisis”. In 1967, 97% of players in the National Hockey League (NHL), the top professional league in North America, were Canadians; a generation later, that figure had slipped towards 60%, and many of the league's more graceful and skilled players were Swedes, Czechs or Russians. When Canada's men failed to win a medal in hockey at the 1998 winter Olympics, that seemed to underline the slide. So a revival campaign was launched—and succeeded. At last year's Olympics, Canada's men and women both won hockey golds.

Ironically, this success has come at the cost of a new fear. Could it be that Canadians have been encouraged to try too hard at hockey? Two lawsuits suggest that they have. In one, a ten-year-old Toronto boy sued the coach of an opposing team for C$10,000 ($6,400); the coach, he alleged, had said that he planned to “put a bounty” on him. The coach denied this, and the suit was dismissed. Now a teenage player in New Brunswick is suing his league for $300,000, saying he should have won its Most Valuable Player trophy.

Trivial as these cases may be, they highlight a character recognizable to most Canadians: the “hockey dad”, who goads and chastises his child to play better, heckles referees, and then berates the coach—all in the hope that his skating sprog will grow up to earn an NHL salary of $1m or more.

Cases of “rink rage”, from verbal abuse to physical assault, are rising. One in three of the 33,000 referees in minor-league hockey leaves each year. “The number one reason is the abuse they take from parents, players and coaches,” says Willi Saari, of the Canadian Hockey Association. Many players and coaches drop out too. So the Association has begun a new anti-crisis campaign. The message this time: “Relax, it's just a game”. If only it were.

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Afghanistan

The rebirth of a nation

Jan 9th 2003 | KABUL, BAGRAM AND BEDAK
From The Economist print edition

AP

Now the country's fragile peace must be made to stick

Get article background

IN LATE afternoon on December 21st, a German Sikorsky CH-53 helicopter swept in low over the edge of Kabul airport. As it passed the roof of a British army base where your correspondent stood with a group of Scottish soldiers, it appeared to flip before dropping like a stone to a dusty alley and exploding. International peacekeepers, Czechs, Turks, Danes and others, jostled at the crash site to pull out bodies. A dilapidated engine of the Kabul fire brigade appeared later, when the flames were already doused. Seven German soldiers were killed in what investigators think was an accident, not sabotage. Their remains were flown home on Christmas Day. Christmas week also saw two Afghans killed and two French aid workers injured in a grenade attack in Kabul, two American soldiers injured when a grenade was lobbed into their jeep also in Kabul, another American shot dead in the east of the country in a fire fight with Afghans opposed to the transitional government of Hamid Karzai, as well as several explosions in Jalalabad and Kandahar. All a sad reminder, as if any were needed, of the cost of supporting regime change in Afghanistan. Has it been worth it?

So far, yes. Afghanistan is better off than it was a year ago. The country is at peace, by its own standards. Mr Karzai's government has been confirmed by a *loyajirga* (grand council) until elections in June 2004; it is extending and consolidating its powers. The World Bank broadly applauds its reconstruction strategy and efforts to stimulate the private sector. A new national currency, the afghani, has been successfully introduced. Several cities have a mobile phone system. Major infrastructure projects have started; some, such as the reconstruction of the Salang tunnel linking the north of the country with the south, will be completed in 2003.

In public at least, Afghanistan has the support of neighbouring countries; none of them wants to dismember it. Iran and Pakistan, long at loggerheads over what sort of government Afghanistan should have, agreed to let Afghans decide. Pakistan has signed a deal with Turkmenistan and Afghanistan to build a $3.2 billion gas pipeline through Afghanistan. A recent donors' conference in Oslo pledged $1.2 billion in aid to Afghanistan for 2003; Norwegian diplomats hope the realised sum may be closer to $2 billion. Some 3m Afghan children are back in school, double the number the United Nations predicted. The remnants of al-Qaeda and the Taliban hiding in tribal areas along the Pakistani border have fewer friends than they did a year ago. They are scattered and on the run; shipments of weapons destined for them have been regularly intercepted.

Most impressive has been the flood of Afghans returning to the country. Afghans formed by far the largest caseload for the United Nations High Commissioner for Refugees. In 2002, nearly 2m of them decided to head home, the largest movement of people anywhere since the formation of Bangladesh.

Despite these achievements, Afghanistan remains in critical condition. Things have not got better so much as less bad. Physically surviving 2003 will be a success for Mr Karzai. He narrowly escaped an attempt on his life in his hometown of Kandahar last year; another attack claimed the life of his vice-president. He has still not visited most of the country he was elected to represent. He is guarded not by his own people but by American mercenaries, who are shadowed by American special forces, who in turn are ringed by peacekeepers. His government needs to gain more credibility with ordinary Afghans this year if it is not to collapse, perhaps bloodily. That means delivering real improvements in the quality of life and making government more representative. Mr Karzai aside, the government is dominated by ethnic Tajiks of the former Northern Alliance whose loyalty, if to anyone, is to the memory of Ahmed Shah Masoud, the charismatic Northern Alliance leader killed by al-Qaeda just before the September 11th attacks on the United States.

The Masoud image, part Bob Marley, part Che Guevara, is everywhere in Kabul: at the airport, splashed across the interior ministry, in stickers on the barrels of the Kalashnikovs carried by the guards at the foreign ministry. A massive colour poster of him, expensively made in Iran, dominates Kabul's football stadium. “A nation needs a hero,” Mr Karzai says defensively of this cult. Maybe, but it is dead Masoud not living Mr Karzai who takes pride of place in ministerial offices. That is a dangerous reflection of the fact there was no viable peace settlement with the fall of the Taliban, only winners: Hazara, Uzbek, and Tajik minorities organised and armed at the expense of the previously ascendant Pushtun majority.

There are still 2m Afghan refugees in Iran and another 1.5m or so in Pakistan. Returnees have descended only on a narrow corridor of the country stretching from Nangarhar and Kabul (a province as well as a city) up to Kunduz in the north. The bombed-out shell of Kabul city itself cannot cope with the influx. Some reckon the capital could quadruple in size to 5m in the next decade. But its sewers are already overflowing, its slender streets gridlocked and choked with a smog laden with wood smoke and dried excrement.

Bandit country

Those returning to villages are scarcely better off. Some coming home to Bedak, a village in the Shomali plain north of Kabul, had their meagre possessions plundered by bandits along the way. The land they came back to was parched, the ancient irrigation systems blown apart during the fighting. The subtleties of harvesting the mulberries, grapes, apricots, plums, apples and walnuts on which Bedak traditionally depends have been forgotten after years in Pakistani refugee camps. That is, if the orchards can be attended at all: the margins of the village are pocked with landmines which continue to maim and kill with an alarming regularity in Bedak as in the rest of Afghanistan.

To take one example, a kilometre from the Bagram airbase, and just off the main road, a crowd gathered recently as the bodies of three Afghan soldiers were carefully dragged clear. Two of the men were already dead, shredded from ankle to pelvis by a landmine or buried munitions. The third, blood-soaked and limp, was taken to the field hospital at Bagram for emergency surgery. Doctors there say they receive landmine victims daily. Most are children, like a young boy wrapped like a football with his arms and legs blown off. NGOs employing several thousand Afghans have for a decade been tracing and destroying the 7m landmines planted by the Russians and by factions in the ensuing civil wars, but they say it will take them another 12 years and $500m before most of them are removed.

The humanitarian effort has been hampered by the three-year drought which, quite apart from war, has devastated much of the country, particularly the south. Rivers and reservoirs have run dry. Three-quarters of the country's livestock has died. Deciding which part of Afghanistan is most in need of attention is difficult at all times—most of the country remains inaccessible by road—but larger projects must deal with the fact that no one knows how many people actually live in Afghanistan. Estimates vary from 16m to 28m. A census this year aims to give a reliable picture, but it will take no account of ethnicity; the composition of the country is a powder keg no one wants to touch just yet.

The Afghan government wants more aid but even if it were forthcoming, say experienced aid workers, it might not necessarily be absorbed. Think of Marjan, a lion in Kabul zoo, which survived malnutrition and bomb shrapnel only to die of indigestion from the first real meal it received after the fall of the Taliban. Relations between ministers and the UN are strained. Ministers complain that the UN, in particular, is wasting money on fancy cars and accommodation. “They could at least be a little grateful,” snaps back one UN official.

Afghanistan has no economy to speak of. There is no effective banking system. The central government raises almost no revenue. Attempts by the government to kickstart small business are foiled by Soviet-educated bureaucrats who set up new obstacles to gain bribes. Warlords such as Ismail Khan, operating out of the western province of Herat, siphon off customs revenue at source, sending only a fraction of the receipts to Kabul. The proposed gas pipeline will not find any investors for some time. The country's valuable exports are either smuggled out (lapis, emeralds, artefacts) or illegal (opium). Some reckon opium poppies contribute $1.2 billion. Over 2,000 tonnes were thought to be harvested in 2002, a 15-fold increase on the Taliban years. A return to the 1970s, when Afghanistan grew enough staple crops to feed itself, is unlikely while high-yield poppies hold sway.

Then there is the question of employment: jobs need to be created to keep men from their Kalashnikovs. A short-term solution is labour-intensive road and irrigation projects, a kind of New Deal for Afghanistan. The government hopes to rebuild 6,000km (3,750 miles) of roads over the next three years, employing tens of thousands of workers at $2 day.

Underpinning everything is the question of security. Nothing can progress, all agree, unless the peace sticks. There are three partners to that: the kernel of a planned 70,000-strong Afghan national army whose regional commands will seek to disarm private militias; an international peacekeeping force of 5,000 watching over Kabul and its surroundings; and an American-led force of 9,000 operating out of air bases at Kandahar and Bagram and charged with eradicating terrorists. The Afghan army, the first step in a possible cantonal system with strong central institutions, is making slow progress. It will take years for it to counterbalance the commander culture that holds valleys hostage to the local gunslinger. The international peacekeepers, at present under Turkish command, have been a success but there are no plans to extend their reach to other cities. American forces are less popular. Confusion between their humanitarian and military work together with the swagger of their casually dressed so-called special forces—a seemingly sweeping term in Afghanistan—has alienated many aid workers and peacekeepers, whose role is more clearly mandated.

Return of the Taliban

Diplomats worry that the United States is wasting its time trying to counteract Iranian influence in Afghanistan's western provinces. Still, European intelligence sources in Kabul agree with their American counterparts that al-Qaeda and the Taliban are regrouping in camps on both sides of the border with Pakistan and are allied now with the battle-hardened fighters of a brutal former *mujahaddin* commander, Gulbuddin Hekmatyar. All the more reason then to step up the reconstruction effort in parts of the country still sympathetic to the Taliban.

Afghanistan was among the poorest and most tribal countries in the world in 1978. Twenty-three years of war and three of drought have left it in an even worse position. Infant mortality is higher, access to clean water, electricity, schooling, and health care all more limited than in 1978. The measure of success is modest but no less urgent. The collision of religious conservatism and limited education has been particularly disastrous for women. Not much has improved for them outside larger towns. Girls in villages are still discriminated against in almost every respect. Attempts to write a new Islamic law code which respects women could yet be thwarted by conservatives. A war in Iraq would distract western media from such injustices. But it will take the full attention and commitment of the international community, even without media interest, to make the peace in Afghanistan stick.

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India and the bomb

300 seconds to oblivion

Jan 9th 2003 | DELHI
From The Economist print edition

Controlling the nuclear decision

Get article background

MORE than four years ago, in 1998, it became clear, following underground nuclear tests, that India could make the bomb. What was not clear was how it should be controlled: what “command and control” structure, to use the official term, was being set up. Officials said that they saw little need to hurry what was a sensitive and complex process because there was a de facto command authority in place, with the prime minister, Atal Behari Vajpayee, in charge of the nuclear trigger. But given India's tendency to defer complex decisions till crises arise, this arrangement has looked worryingly inadequate. Although China's nuclear capability is seen by many strategists as India's main long-term concern, the immediate threat is posed by Pakistan's nuclear weapons, which could take only 300 seconds to reach Delhi. What would happen if 79-year-old Mr Vajpayee were sleeping during those precious seconds, or was killed?

On January 4th, India's cabinet committee on security provided some answers with a statement that a Nuclear Command Authority has been created, comprising political and executive councils, plus a “strategic forces” command, to be headed by a senior air-force officer. The Political Council, with the prime minister as its chairman, is the sole body that can authorise the use of nuclear weapons. Its other members include four senior ministers and Brajesh Mishra, India's national security adviser. Mr Mishra heads the Executive Council that includes military officers, scientists and civil servants. Its job is to advise politicians regularly on the risks of a nuclear attack.

Reuters

Who pulls the trigger if the prime minister is asleep?

India continues to reassure Pakistan that its policy is not to be the first to use nuclear weapons, hoping to reduce the risk of its neighbour launching a pre-emptive strike. But this week's statement gives warning, for the first time, that India could retaliate with nuclear weapons if it came under a biological or chemical attack.

What happens if a nuclear strike wipes out Delhi, the prime minister and the rest of the Political Council? Alternative bodies with authority to use the bomb in such circumstances have been set up elsewhere in India. Defence analysts are questioning how effectively the alternative system would work in practice. They suggest that it could take two or three years to install secure links between alternative command centres and India's air force, army and submarines. But India's determination to face down Pakistan is clear, with the threat of massive response to a nuclear attack.

George Fernandes, India's defence minister and a member of the Political Council, told a business

conference on January 7th that, while India would suffer a little in a nuclear war, there would be no Pakistan left after its retaliation. Mr Fernandes was responding to remarks made in December by General Pervez Musharraf, Pakistan's president, who controls the country's nuclear capability. The general appeared to suggest that he would have ordered a nuclear strike last year, if India had attacked Pakistan with conventional forces after terrorist attacks on its Parliament and on Kashmiri civilians.

This nuclear sabre-rattling is causing concern internationally at a time when Pakistan-backed terrorist attacks are increasing in Kashmir, raising the prospect of confrontations similar to those of last year. This week's statement at least shows that India's leaders are trying to master subcontinental security, even if it has taken them four years to get around to it.

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Singapore and Malaysia

Introducing newater

Jan 9th 2003 | SINGAPORE
From The Economist print edition

The city state's bid for self-sufficiency

SINCE the start of this month, Singaporeans with a keen sense of taste may have noticed that their tap water has a subtle new flavour. The rain and river water in the city state's reservoirs is being mixed with recycled waste-water from air-conditioners, sinks and toilets. The government cheerily dubs the brew newater, and despite a tide of scatological humour, insists that it is cleaner than the stuff that used to come out of the tap. It has built a demonstration plant, where earnest technicians counter jibes about "loowater" with graphic explanations of their many state-of-the-art purification procedures. The prime minister has shown the way by swigging from a bottle of newater after a game of tennis.

Singapore relies on neighbouring Malaysia for about half of its water supply. But from time to time Singapore's newspapers raise the spectre of a hostile regime in Malaysia turning off the tap. That seems unlikely, given the close ties between the two countries. Rather, Singapore's move towards self-sufficiency for water seems to be prompted by pride. The two countries formed an unhappy and short-lived union in the 1960s, and have been bickering about the terms, causes and consequences of its dissolution ever since. Singaporean leaders, it seems, would rather drink their own purified effluent than rely on Malaysia for anything, while their Malaysian counterparts cannot resist the temptation to pick a populist fight with their former compatriots.

Two treaties, dating from 1961 and 1962, govern Malaysia's sale of water to Singapore. They both fix the price at three Malaysian sen (less than one American cent) for every 1,000 gallons, although they provide for a review of that figure after 25 years. In the meantime, Singapore sells treated water back to the Malaysian state of Johor for 50 sen per 1,000 gallons. Johor does not have a treatment plant of its own. The arrangement benefits everyone: Malaysia is able to sell water that would otherwise simply flow into the sea; Singapore gets a cheap and reliable supply.

Too cheap, according the Malaysians, who want to invoke the price-review clause. They point out that water from the Chinese mainland is sold to Hong Kong for almost 100 times as much. Singapore, however, argues that the review could only have taken place in the 25th year of the contracts (that is, in 1986 and 1987), and not at any point thereafter. Anyway, it says, the subsidised rate at which it sells the treated water back to Johor more than makes up for the low purchase price. It is now threatening not to co-operate with Malaysia on other bilateral issues.

But the row is more than rhetorical. Singapore is going to vast expense to find an alternate water supply. In addition to the newater scheme, it has commissioned a desalination plant, and is building an elaborate drainage system to capture almost all the rain that falls on the island. The Malaysians are equally stubborn: Johor Bahru is building itself a pricey treatment plant, to put an end to its humiliating reliance on subsidised Singaporean water.

Such nationalist bluster goes down well in both countries. Malaysian youths have taken to protesting outside the Singaporean embassy in Kuala Lumpur, and are threatening to occupy an islet claimed by both countries. And the dispute at least provides local comedians with an endless supply of jokes.

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North Korea and America

A possible way out

Jan 9th 2003
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Giving diplomacy a chance

WHEN you are in a hole, stop digging. When you are in an unwanted diplomatic spat, set aside the megaphone. That, tentatively, is what the Bush administration did this week over North Korea's nuclear rule-breaking. Will the North's Kim Jong Il do likewise?

America had previously insisted that there could be no negotiation with North Korea until it verifiably dismantled an illicit uranium-enrichment programme it recently owned up to and reinstated a freeze on its plutonium production. This week George Bush sounded a touch more conciliatory. He is anxious not to complicate efforts to keep the squeeze on Iraq, another miscreant, and is under pressure from South Korea and Japan, as well as from China and Russia, to find a diplomatic solution to the stand-off. But while the president said there could be talks, his officials insist there will be no new inducements.

In a carefully-worded joint statement with South Korea and Japan, America said it would talk to North Korea "about how it will meet its obligations to the international community". North Korea insists it will give (so far, only vague) assurances about its nuclear activities only in talks with America and after the signing of a non-aggression treaty. The Bush administration, determined to break the cycle of concessions that seemed to reward the North's bad behaviour, is keen to remind it and everyone else that it is violating the Nuclear Non-Proliferation Treaty.

EPA

Is Kim listening?

North Korea has long failed to live up to its treaty promises in full, or its safeguards agreement with the International Atomic Energy Agency, the treaty's UN watchdog. Earlier this week, the agency's 35-nation board gave North Korea a last chance to co-operate with its inspectors before taking the matter to the UN Security Council.

North Korea's flagrant disregard of its obligations by enriching uranium for a second weapons programme may this time prove a miscalculation. Its earlier plutonium production is thought to have produced enough fissile material for at least a couple of bombs, before it was frozen under a 1994 deal that involved compensation in the form of oil deliveries, chiefly from America, and the provision of two western-designed nuclear-power reactors, chiefly by South Korea and Japan. But all that is now on hold. And even China, the North's semi-friend, now agrees that its weapons dabbling has to stop.

Amid shrill rhetoric, the North this week repeated that it was ready for talks with America "without preconditions". Is that a softening of its demand for a non-aggression treaty up front (a non-starter for America's Congress)? That is for South Korea, Japan, China and Russia to explore.

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Japan's changing social habits

Crimes shared

Jan 9th 2003 | KANAGAWA
From The Economist print edition

New laws on drink and smoking

SHOULD you have the misfortune to be a passenger in a car where the driver is found to be under the influence of drink, the chances are that a Japanese court will punish you too. The police say that it is nothing new for a passenger to be charged with being an “accessory” to the offence. But, in practice, since new drink-driving laws came into force in Japan last June, courts are taking a tougher line with passengers as well as drivers.

Under the new laws, even one medium-sized drink can land a driver in trouble. He can be fined up to ¥500,000 ($4,170), with prison for particularly nasty cases. As for his passengers, nearly everyone, it seems, has stories, personal or acquired, of a group of travellers in a car being hit with a total of ¥1m or more. Whatever the police say, it is widely believed that there are now automatic fines for passengers riding with tipsy drivers. This fear of being blamed along with the driver has given particular force to the new laws.

The policy seems to be working. On January 2nd it was reported that Japan's 8,326 road deaths last year were nearly 5% fewer than in 2001. In 30 years the number has halved. Increasingly tough penalties for drunken driving are said to have been a big factor.

While most Japanese approve of the new laws, they have brought gloom to restaurateurs, who are already hit by Japan's sinking economy. Much of the pleasure of eating out comes from accompanying your meal with a bottle of wine. If even a glass is a risk, you may decide to eat at home.

Suburban areas, such as around Odawara, a scenic city in Kanagawa prefecture, Tokyo's south-western neighbour, where cars, rather than trains or buses, are the most common means of transport, have been particularly hard hit. Local residents say restaurant car parks have been noticeably empty since drink-driving laws were tightened. Several local dining spots have closed.

Struggling restaurant owners may be tempted to move to Chiyoda ward in Tokyo, where another new regulation, banning smoking in the street, has been forcing some desperate smokers into cafés instead. But becoming a refuge for smokers is hardly likely to prove to be a money spinner. A smoker can make a cup of coffee last rather a long time.

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Saudi Arabian reform

Praying to make their kingdom nicer

Jan 9th 2003 | RIYADH
From The Economist print edition

Impact

Education is one of the reforms that is slowly stirring in Saudi Arabia

Get article background

“WE'RE the most conservative country in the world,” shrugs one of Saudi Arabia's 5,000 princes. With its enforced puritanism, medieval system of governance and culture of secrecy, the kingdom appears uniquely resistant to change. Yet, even here, something at last is stirring.

The reforms so far are patchy and halting. Government jitters over the looming war on Iraq, the apparent hostility of their long-time American ally, and the reactionary surge in xenophobia, have stalled more overt efforts. Yet, taken together, recent moves to open the economy, address brewing social problems and encourage a healthier atmosphere of debate have begun to create a momentum for further-reaching reform.

The changes come none too soon. Saudi Arabia is facing a barrage of problems, unprecedented in its history. While its population has doubled in 20 years to 23m, income from oil has remained flat, with no prospects for sustained growth. Spending per head on infrastructure has been halved in the past decade, leading to strains on basic services that are bound to grow without a massive infusion of private investment. Unemployment among the young has mounted inexorably, even as the doctrinaire and heavily religious education system continues to leave graduates unprepared for the job market. And young and old quietly express deepening dismay at the opaque and often arbitrary judicial and legislative systems.

The pressures from abroad are equally daunting. The Americans demand support for their campaign against Iraq, a campaign that is viewed with brittle suspicion by the general public, and seen by even pro-American members of the Saudi elite as offering more dangers than rewards. Making matters worse, America's public declaration of its intention to promote democracy as a foil to extremism signals an end to its cosy old relationship with the Gulf oil monarchies.

America has also attacked the Saudi school system, accusing it of indoctrinating pupils with Islamic fundamentalism. Further pressure has come on the economic front, with demands that the kingdom revise restrictive commercial codes and increase transparency if it wishes to join the World Trade Organisation.

Like every other autocracy, the Saudi government finds it easier to respond to economic issues than to political or social ones. It has begun to court foreign investment energetically, passing favourable legislation, launching a wide-ranging privatisation drive, and opening new fields to foreign participation.

The most significant initiative, a $25 billion scheme to attract oil majors into three huge natural-gas projects, remains stymied in haggling, but the betting is that at least one of the projects will overcome resistance from the jealous state oil monopoly and soon go ahead.

Meanwhile, laws to streamline regulation of capital and labour markets have been tabled, as well as others covering insurance, commerce, taxation and monopolies. Progress has also been made in modernising the legal system, a peculiar and cumbersome hybrid of Islamic and statutory law. The country's fiercely independent *qadis*, or Islamic judges, are now, in theory at least, bound to respect systematised procedure and the right of lawyers to defend clients. The changes are necessary and good, says one Riyadh lawyer, but he cautions that it may be some time before they are fully respected.

More than charity needed

Social issues are a more delicate matter. A widely publicised recent visit by Crown Prince Abdullah, the country's acting ruler, to a poor district of the capital was hailed as an unprecedented admission that the country suffers from poverty—and seen as signalling that the state may seek to tackle it by more efficient means than the traditional charity doled out by princes.

The government has already taken some aggressive measures to promote employment, a particularly tricky issue in a job market still dominated by expatriate labour that costs, on average, a third of what it costs to hire Saudi nationals. Most sectors now operate under rules to raise quotas of Saudi employees every year. Saudisation, as it is called, is not easy. In banks, for instance, around 80% of workers are now Saudi, but bankers say that if the quota is pushed further it will begin to impinge on top-quality management.

Educational reform is even trickier. Calls for change, largely because schools were failing to produce needed skills, have long been sounded. The Shura Council, an appointed body that acts as a sounding board for policy, and is seen by some as a nascent parliament, was set to debate the question in August 2001. After September 11th, the issue grew too hot, as Saudis bristled at American criticism. But education is again quietly on the agenda, having gained impetus last year when the government, responding to the scandal of a deadly fire in a girls' school, removed female education from the control of the religious authorities and placed it under the Ministry of Education.

The reforming trend is clear, but many Saudis complain that the changes remain cosmetic. Freedom of the press, and therefore public debate of essential questions, is still severely restricted. This is true not only at home but also in other Arab countries where criticism of the kingdom is limited by the reach and power of Saudi money.

A flurry of criticism last year, prompted by the school fire, was quickly brought to an end by renewed state controls. There are rumours of plans to hold limited local elections, and to broaden the mandate of the Shura Council. Some enlightened princes even talk of the country evolving towards constitutional monarchy. But the basic fact, says a wry critic in Riyadh, is that so long as the government gets its money from God, it remains impossible to demand accountability.

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Israeli politics

Sloshing the mud around

Jan 9th 2003 | JERUSALEM
From The Economist print edition

The Likud still seems to be set to win the election, but not unmired

Get article background

ARIEL SHARON'S confident suggestions that, after an Iraqi war and after Israel's election, he will be negotiating with new Palestinian leaders lost some of their cogency as the week wore on and the Likud and its leader found themselves embroiled ever deeper in allegations of financial impropriety. On January 7th, a newspaper, *Haaretz*, reported that the police were investigating the Sharon family's finances. Party insiders, for the first time, voiced fears that the welter of sleaze was seriously sapping the Likud's electoral strength.

The investigation reported in *Haaretz* evolved out of campaign-finance offences committed by Mr Sharon in 1999, and his subsequent efforts to repay cash contributions that he ought not to have taken. Another newspaper, *Yedioth Ahronoth*, investigating another episode, claimed on January 2nd that Mr Sharon's son, Gilad, might have been involved in influence-peddling. This has been denied, and a police investigation, which ended some months ago, has so far resulted in no action.

The two newspaper stories come on top of media reports and police investigations of alleged vote-buying and other goings-on at the Likud's primaries last year. Some irregularities are said by the media to involve another of Mr Sharon's sons, Omri, who has become a powerful figure in the party and is high on its list of Knesset candidates.

The prime minister calls all this a dastardly plot, and denies any wrong-doing. The outlook is still for a Likud victory on January 28th. But, as with Richard Nixon in 1972, the election may not be the most serious challenge ahead of Mr Sharon. Long after it is won, he and others may yet be fighting for their political lives.

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Israel and the Palestinians

Who's to blame for the Tel Aviv bombs?

Jan 9th 2003 | JERUSALEM
From The Economist print edition

AP

Israel holds Yasser Arafat responsible but his control over his men is ever weaker

Get article background

"THIS will put the election campaign back into proportion," a Likud party worker asserted grimly, as he watched the bloody scenes in south Tel Aviv on January 5th, where two suicide bombers killed 22 people and injured more than 100. The bombers, young men from Nablus, had mingled unnoticed on the teeming, down-at-heel streets around the city's old bus station. They struck in quick succession, their bag-bombs packed with nails to increase the carnage. People fleeing the first explosion were caught by the second. Many of them were foreign workers.

Terrorist attacks at election time play into the hands of the right, says the conventional Israeli punditry. In their anger and grief, voters gravitate to hardline politicians preaching military solutions to the conflict. This time, things are more complicated. Ariel Sharon and his top Likud ministers flailed around frustratedly for a response that would assuage their public without compromising American concern to keep the region quiet as the build-up for a likely war on Iraq goes forward.

The Likud was also worried that the bombings, coming after several weeks without an attack inside Israel, might have reminded people of the flaws in Mr Sharon's military solution. The army has reoccupied most of the West Bank towns, but assailants still get through—though officials argue that dozens of bomb-plots are thwarted thanks to the sieges and road closures and wholesale arrests.

In the event, Mr Sharon chose a diplomatic conference in London as the target for his fiercest retaliation. Initiated by Tony Blair, the gathering was to bring together next week a number of Arab states and the members of the Middle East "quartet"—America, the EU, the UN and Russia—to hear from the Palestinians of their progress on political reform, and probably other issues as well. Mr Sharon, peeved anyway at not being invited, has now barred the Palestinians from going. They would be mere puppets of Yasser Arafat, pronounced Binyamin Netanyahu, Israel's foreign minister, and so long as Mr Arafat still pulled the strings all talk of reform was hollow.

Israel brushed aside British remonstrances, noting that the Americans did not seem too distraught that the conference would now probably have to be postponed. Strong hints have been dropped, by Mr Sharon as well as by others, that Mr Arafat will be deported as soon as America has finished its war on Iraq.

But can Mr Arafat be held to blame for the recent terrorism? Responsibility was claimed by the al-Aqsa Brigades, the self-declared military wing of his Fatah movement. The claim was swiftly disowned by Fatah, which reaffirmed its commitment to the ceasefire talks going on between Palestinian factions in Cairo. The Palestinian Authority (PA), which denounced the Tel Aviv carnage as “a terrorist attack”, vowed to confront the perpetrators “firmly”. But this is a vainglorious pledge, given the ramshackle state of the PA's security forces in most of the occupied West Bank and large parts of Gaza.

The truth is that Mr Arafat's Fatah movement could barely be in greater disarray. The Brigades, formed in the early months of the *intifada* as “self-defence” militias, have evolved into an increasingly autonomous military force. Their independence has been nurtured by Israel's closure policy, which cuts off each region from the next, and by the collapse of the PA as a central governing authority. Many of the local leaders of the Brigades, who see themselves as forging a new national movement out of the debris of the old, assert that they are not bound by any decision from the “defeated” leadership—which would include Mr Arafat himself.

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Iranian justice

A very strange confession

Jan 9th 2003 | TEHRAN
From The Economist print edition

Abbas Abdi, an architect of reform, has let his colleagues down with a bump

Get article background

GOING to jail counts as victory, so long as you go in a blaze of eloquent defiance, or so says the code that governs Iran's public life. Ever since conservative judges started imprisoning the reformists gathered around President Muhammad Khatami, Iranians have come to expect courtroom heroics from condemned freedom-seekers. But they have been disappointed by Abbas Abdi, an architect of reform, and their movement has been thrown into confusion.

When Mr Abdi's trial for espionage started last month, an anticipatory cheer rippled through the stands. Mr Abdi had, in the past, emerged from solitary confinement and worse even hungrier for the fray. His friends predicted that he would use the trial to lampoon his opponents, and to ridicule the weird-sounding accusations about the polling institute that he used to run. They expected him to repeat his earlier recommendation that reformists should show their disgust by quitting public life, as well as again making his call for a referendum on Iran's form of government.

But Mr Abdi's court appearance on December 25th saw an extraordinary volte-face. Having paid oleaginous tribute to the governor of the notorious prison where he was being held in solitary confinement, Mr Abdi promised to "atone" for organising opinion polls that could have harmed the national interest. The polls, conducted for domestic and foreign clients, including Gallup, showed among other things that 74% of the people living in Tehran would like to see an official dialogue with America. Mr Abdi also disavowed the strategy of calling for mass resignations, and pooh-poohed all notion of a referendum. The conservatives, naturally, were delighted.

Reuters

Why did Abdi do it?

Mr Abdi's ideas about non-co-operation have dominated politics since last summer, when the Friday-prayer leader in Isfahan became the first important reformist to resign. The president has let it be known that he will step down if the conservatives block two bills, currently progressing laboriously through parliament, which seek to slash their powers. Reformist parliamentarians have issued similar threats, and calls for a referendum coloured the student protests that lasted for more than a month at the end of the year.

The trial has grown in complexity. During his defence, Behrouz Geranpayeh, one of Mr Abdi's co-defendants, obligingly denounced some well-known reformists who had, he said, commissioned and financed the poll on relations with the United States. On January 6th, one such reformist, Ahmed Bourqani, was in court to refute charges that he had diverted public funds to Mr Geranpayeh.

The conservatives are rumoured to have picked out some 60 reformists for future imprisonment. Indeed, some conservatives hope that the Abdi trial will engulf the main reformist party and lead to its banning. Judges may ignore the immunity that is supposed to protect parliamentarians; they have done so in the past.

But none of this sheds light on why Mr Abdi recanted. Some of his friends think he wanted to protect his wife, who was employed by his institute, from a threatened court case of her own. There is a second theory, not incompatible with the first: Mr Abdi is committing political suicide in order to avoid revelations to do with national security that could have sorely embarrassed senior reformists, and provided the

United States with an excuse to increase its already considerable bellicosity towards Iran.

This theory is based on the secret documents that were discovered, according to the prosecution, among Mr Abdi's possessions. These documents led to the cross-examination, behind closed doors, of the government's spokesman. What, many outside the courtroom would like to know, was Mr Abdi doing with such documents, and where were they destined?

America's shadow falls on the case. Mr Abdi was arrested on November 4th, 23 years to the day after he, as a youthful Islamic revolutionary, had helped to take over the American embassy in Tehran. When, during his courtroom apology, Mr Abdi cited “sensitive conditions”, and the danger that poll findings could be “exploited”, he was referring to fears that the United States, once it has dealt with Iraq, will seek an opportunity to attack or otherwise destabilise Iran.

Conspiracy-minded reformists refer to the Persian verses that relate the endeavours of a Jewish king to sow discord among his Christian subjects, by planting his mischief-making minister among them in the guise of a convert. Mr Abdi, remark the conspiracy-theorists, could not more surely have raised reformist hopes, and then destroyed them, if he had been on the conservatives' payroll all along.

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South African politics

Buthelezi is not to be cowed

Jan 9th 2003 | DURBAN
From The Economist print edition

But relations between the ANC and Inkatha are getting worse and worse

THE cliché of choice is “tinderbox” as observers watch the African National Congress (ANC) and its national coalition partner, the Inkatha Freedom Party (IFP), squaring up to one another. The main arena for the quarrel is KwaZulu-Natal province, where the ruling IFP ejected two ANC ministers from the provincial government late last year. Adding insult to injury, the IFP formed a partnership instead with the opposition Democratic Alliance. On January 8th, Inkatha leaders backed down from a threat to dissolve KwaZulu's parliament, and to call elections.

Local ANC politicians say that elections would have been impossible anyway without a new electoral law, and are demanding revenge for their ejection. Dumisani Makhaye, one of the local leaders, has called for “rolling mass action” in the province: a reference to the violent street protests that were used against apartheid rule. Others want Inkatha ministers to be expelled from the ANC-dominated national government. The ministers may not need to be pushed. This week an IFP spokesman, Musa Zondi, pointed out that “it is difficult for us to continue there.”

Both sides admit that relations are at their lowest ebb since 1994, the year that a deal was struck to form a government of national unity, ending the clashes that had killed thousands of people in the 1980s and early 1990s. Thabo Mbeki re-invited the IFP to share power after the 1999 election. If that deal now unravels, KwaZulu-Natal may be in for an upsurge of violence.

The two parties have been openly squabbling over the past 12 months. Mangosuthu Buthelezi, Inkatha's leader, serves as the country's minister of home affairs, but this does not inhibit him from regularly complaining about the government's policies on AIDS and labour regulation. He has accused Mr Mbeki of appointing a civil servant to his ministry who has stymied reform of the immigration law. Inkatha leaders grumble that Mr Mbeki does far less than his predecessor, Nelson Mandela, to nurture good inter-party relations. And ANC politicians, at least in private, admit that planned laws to reform the role of traditional chiefs are likely to hurt the IFP's interests, since the party gets most of its votes from rural constituencies in KwaZulu-Natal with the help of such chiefs.

Even more threatening is a looming crisis over the ANC's frustrated attempts to alter the constitution to allow members of parliament to change parties between elections, without losing their seats. The suggested new rules had already encouraged some provincial Inkatha parliamentarians to try to defect, an action that would hand control of KwaZulu-Natal's parliament to the ANC. The quarrel was so serious that Mr Mbeki, returning early from holiday this week, had to hammer out a floor-crossing compromise.

Mr Mbeki has managed to reduce the tension. But more fights are expected before the general election next year. The ANC seems to have felt less need to cosset the IFP since another party, the New National Party, was tempted into the government last year. And Inkatha, which says it will campaign as part of the opposition in 2004, is determined to assure voters that it is not cowed by its bigger partner.

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Moroccan interrogation

Bad memories reawakened

Jan 9th 2003 | RABAT
From The Economist print edition

Morocco's human-rights lobby is striving to prevent a backward turn

SENIOR American officials passing through Rabat routinely congratulate the Moroccan authorities on both their "superb co-operation" in the campaign against terrorism and their courageous political reforms, including, implicitly, progress on human rights. The two policies, however, could be working against each other. Helping the Americans forestall terrorism, say some Moroccans, may be jeopardising the shaky progress made on human rights.

Last month, three Moroccan human-rights groups said that the security services were returning to old habits of "disappearing" suspects into unofficial interrogation centres. The custom had largely died out until last May, when three Saudis living in Morocco were picked up on suspicion of planning to attack American and British warships in the Strait of Gibraltar. Other arrests have followed of people regarded as potential al-Qaeda collaborators.

The list of "disappearances" which the human-rights groups presented to the interior and justice ministries is not long. It features a score or so of detainees, including the three Saudis and their alleged Moroccan accomplices. It notes that after weeks or months in clandestine interrogation centres—the main one apparently a villa on the outskirts of Rabat—the Saudis and most of the others on the list were eventually handed over to the judicial authorities. Although a new name on the list is that of a man deported to Morocco by Britain on December 19th, all the remainder have been released without charge.

Not so bad, compared with the record of many other countries. But the issue has emerged as a test of strength for the human-rights lobby, made up largely of left-wing sympathisers, often themselves former political prisoners. Although not natural allies of the suspected Islamists, some of whom have recently returned from Afghanistan, the activists are haunted by memories of the dark years of the 1970s and 1980s, when Moroccan interrogators acquired a reputation for their torture techniques, and hundreds of political detainees were never seen again.

The human-rights lobbyists, together with Islamists from the Justice and Development Party, maintain that dozens of other illegal detentions last year went unreported. They say that this latest crop of detainees were blindfolded during interrogations, and then verbally abused, beaten and sometimes tortured, in ways that included having their heads held under water.

Although the government insists that these worries are without foundation, it announced this week that it will extend the period detainees may be legally held in police custody in cases concerning "internal or external security''. And American officials will neither confirm nor deny persistent reports that the Moroccan security services have carried out follow-up interrogations of al-Qaeda suspects handed over to them by the CIA. Inquirers are merely referred back to the Moroccan authorities.

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Reform in Germany

Is the chancellor plucking up courage at last?

Jan 9th 2003 | BERLIN
From The Economist print edition

After months of apparent retreat, there are signs that Gerhard Schröder may be contemplating real reform of his country's ailing economy

Get article background

JUST when Gerhard Schröder, Germany's chancellor, was beginning to look as if he could do nothing right, he may at last be starting to get his act together again. Over the past few weeks, he has managed to impose his authority on his rebellious party, clinched a deal with the opposition on sorely needed labour-market reforms, slashed taxes on savings, put forward a raft of proposals to help small businesses, and, if a leaked strategy paper from his office is to be believed, is at last contemplating an overhaul of Germany's generous welfare state, with a strong new accent on personal responsibility. Does this mean, then, that Mr Schröder will pursue the business-friendly policies of the “new middle”, much touted when he first took office four years ago but abandoned thereafter?

It is too soon to say. With the best will in the world, Mr Schröder has a very long way to go. Most of the indicators remain gloomy, few businessmen have much faith in their chancellor, and some economists say that Germany is still facing its worst crisis since the end of the second world war. Last year the economy is estimated to have grown by a miserable 0.2%; few expect it to do much better this year. Unemployment hit 4.2m last month, its highest level since mid-1998, and is expected to go on rising. Consumer confidence is at its lowest ebb since 1994. The DAX, Germany's leading stock-exchange index, fell last year by 44%, the biggest drop in any of the world's rich countries. The bankruptcy rate has never been higher. Public-sector workers have been threatening to launch their first nationwide strike in a decade. And even exports, the sturdiest pillar of Germany's economy, are being undermined by the euro's rise in value and by the threatened war in Iraq.

But at least Mr Schröder is again making the right noises. “We will only be able to keep up our standard of living, our welfare system, our good schools, roads and hospitals, all of which are the envy of so many people abroad, if we gather up the courage, together, to accept fundamental change,” he said in a New Year's Eve address to the nation. “Everything must change so that everything can remain the same,” he said a few days earlier. “We must alter our mentality.”

After weeks of discussion within government ranks of how to make the rich pay more, just before Christmas Mr Schröder surprised everyone and pleased businessmen by announcing plans for a new savings tax which will actually leave higher earners better off. In place of the present 30% savings tax that rises to 48.5% for those paying the top income-tax rate, a single flat-rate savings tax of 25% is to

be introduced, along with an 18-month amnesty to encourage the return from abroad of an estimated *euro*300 billion ($313 billion) held by German tax-evaders. Those who bring back funds by January 1st 2004 would have to pay a 25% tax on the total, rising to 35% for funds repatriated over the six months after that, though the laggards would be immune from criminal charges.

Meanwhile, all talk of a wealth tax has been quashed. The trade unions, who had lobbied hard for its reintroduction, are feeling particularly aggrieved. They had previously appeared to have the upper hand in the new government. Now their views seem to be increasingly ignored. The government has announced plans, for example, to extend Germany's notoriously restrictive shop-opening hours from 4pm to 8pm on Saturday—a small step, but one that could well be lengthened, once the bill reaches the Bundesrat, parliament's upper house, where state premiers from all the main parties have already said they will press for a further relaxation of the law.

Finding his backbone

Mr Schröder may also be steeling himself for labour-market reform, after several months when he seemed to be wilting under pressure from the unions. At first his new government had appeared to be watering down the proposals of Peter Hartz, a Volkswagen manager, to make the labour market more efficient. In particular, the chancellor seemed to be caving in to union demands that jobless people employed by the proposed new “temp” agencies (probably to be run by private agencies under contract to the state) should be paid at the full union rate, whereas Mr Hartz's commission had suggested that they be paid a lot less, to make them more attractive to employers.

But now it looks as if Mr Schröder may be plucking up the courage to take on the unions on this score, and may even widen the low-wage sector more daringly than Mr Hartz himself had suggested. Pressed by the conservative opposition, he has agreed to raise the wage ceiling for so-called “mini-jobs”, where workers are exempt from all social welfare contributions, from *euro*325 to *euro*400 a month; those earning *euro*401-800 would pay reduced rates. Employers, who normally share with the worker welfare costs amounting to nearly 42% of gross wages, would pay a flat-rate contribution of 25% on jobs up to *euro*400, reduced to 12% for mini-jobs (cleaners and au pairs, for example) in private households.

The unions have been further dismayed by a deliberately leaked strategy paper drawn up in Mr Schröder's office that calls for “wide-ranging and fundamental reforms” in Germany's welfare system, particularly health and pensions, including cuts in benefits and the injection of more private-sector competition. Cuts in taxes and in non-wage labour costs, says the paper, are the key to regaining confidence in the economy. No details are given as to how this might be achieved. But the tone is new and has given a bit of hope to those who had begun to despair that the new government would ever embark on the painful reforms needed to put Germany back on the path to recovery.

Yet another hopeful sign was a “discussion paper” published this week by Wolfgang Clement, the new super-minister for economics and employment. He sets out a raft of measures to help the small and medium-sized businesses of Germany's beleaguered *Mittelstand*, which provides jobs for around 70% of German workers but has hitherto felt left out in the cold by Mr Schröder's government. Among other things, Mr Clement suggests slashing taxes and red tape for small-business start-ups and for self-employed people at the bottom end of the wage scale, as well as easier credit for all *Mittelstand* firms.

All good stuff. But can Mr Schröder deliver? In the past, when the going has got rough, he has tended to shy away from taking tough decisions. But the situation is getting too dire to be rectified by the old method of compromise and consensus. If his remarks of the past few weeks are sincerely meant, the chancellor may be coming round to that view too.

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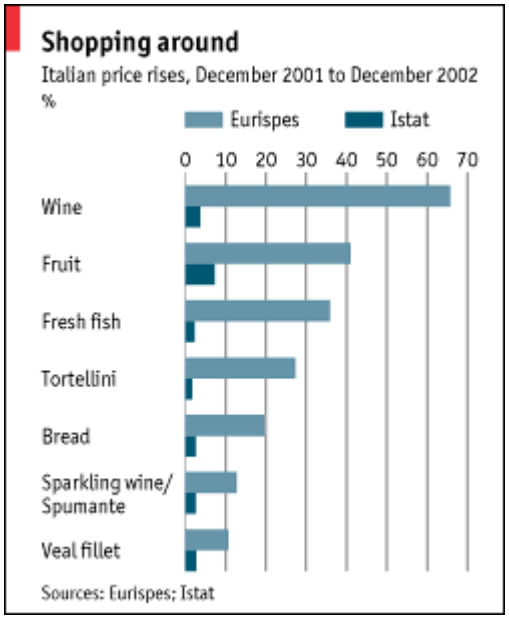
Italy's economics and statistics

Poorer, yes. But by how much?

Jan 9th 2003 | MILAN
From The Economist print edition

Italians don't know, but they blame the euro



HOW much did the price of oranges go up in 2002? By 7% or 41%? Bread: 2.5% or 19.5%? Veal: 2.6% or 10.6%? The official statisticians of Istat put last year's overall inflation at 2.8%, with the price of food up 3.2%. Tosh, says the woman on the Milan tram, and a rival institute, Eurispes, puts food inflation at 29%. Istat is threatening to sue.

For its part, a consumers' organisation, Altroconsumo, says the price of oranges rose by 18.5%, meat 6.5%. And that of jeans by 14%, laundry services and public transport about 10%, a cappuccino 5%. And so on: in short, a lot. Just how far or why, no one really knows. But one thing is sure: as shopkeepers in January converted to the euro—at, in theory, 1,936 lire to *euro*1—prices in the new currency were not just quietly rounded up (that was illegal) but leapt. And Italians, says one poll, went from being the euro's most enthusiastic fans to its most disappointed.

Nor is inflation the only way of feeling poorer. A rash of news and statistics has reminded Italians that times are bad. Economic growth in 2002 was a measly 0.6%. The government is casting around for cash: *euro*8 billion from a dozen amnesties, covering things from tax evasion to false accounting; *euro*2 billion or so from speeded-up payments by banks and by bodies that collect quasi-tax money (eg, for public services); *euro*500m from the sale of 40 public buildings. Meanwhile, battered Fiat is still to find a rescuer.

There is more, and worse. Italians are being told that they lag behind in innovation: according to a study commissioned by *Corriere della Sera*, Italy is down with Spain, Portugal, even Greece, in vocational training, scientific knowledge of its citizens, individual spending on technology, use of the internet, patents and, crucially, resources devoted to research and higher education.

Giovanni Peri, an Italian economist at the University of California, has calculated that up to 5% of new graduates leave the country. Italian graduates seeking work abroad are seven times as numerous as foreign ones finding a job in Italy. This topic too brought a heated public debate last week, when a world expert on organ transplants, Ignazio Marino, the American-trained head of Ismett, a state-of-the-art medical centre in Palermo, decided to return to the United States, saying he could not work in Palermo: too many obstacles and too much red tape. The health minister denied that, but took a swipe at the academic system: “Young Italians are blocked by a gerontocracy. University barons only want to dish out jobs to their relatives. Individual merit doesn't count,” he said, and “Italy is paying a heavy price for that.” Expressed, presumably, in euros.

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France and farming

The case for the defence

Jan 9th 2003 | PARIS
From The Economist print edition

Free trade is the wrong answer, says Jacques Chirac's farm minister

HERE was a French farm minister in Britain spelling out—in English—the virtues of the European Union's protectionist common agricultural policy (CAP). But Hervé Gaymard is not a man to risk his larynx for fun. His speech to an Oxford farming conference this week was part of a campaign as the world's rich and poor define their positions—the deadline is March 31st—for the Doha round of world trade negotiations. His message: France will protect its farmers from free trade.

How? It has, of course, to act through the EU. No problem. President Jacques Chirac, on the eve of an EU summit last October, made a private deal on farm spending with Germany's Gerhard Schröder that neatly blew away British dreams of full-scale reform of the CAP as the EU readies itself to take in another ten new, subsidy-hungry members.

Mr Gaymard had already, in September, corralled six other EU farm ministers—enough to block any contrary majority—into jointly denouncing the European Commission's plan to decouple subsidies from production. Then, last month, he and France's ministers for foreign trade and aid jointly rounded on the Australian trade minister, Mark Vaile, who, in line with his colleagues in the "Cairns group" of countries that do not subsidise their agricultural exports, had just accused the CAP of "strangling" the world's poor. Not true, says Mr Gaymard: the Cairns countries should concentrate on American subsidies, especially for its cotton, rice and groundnut oil—crops in direct competition with those of the poor in Africa and Asia.

But "we're all sinners" is not the essence of Mr Gaymard's message. Not at all: everyone, not least other EU countries, should start from the premise that "farm products are more than marketable goods". Farming is part of a nation's culture, and literally rooted in the land: farmers, unlike manufacturers, cannot simply switch from one location to another.

Nor is the CAP to blame for all the EU's farming ills. Did it cause mad-cow disease? *Non*. It does not subsidise pigs or poultry, so don't blame it for the pollution caused by Brittany's pig farmers. Nor should consumers complain. Food is only 16% of an EU family's budget compared with over 50% when the CAP started some 40 years ago. So one may object that the CAP makes Europe's citizens pay twice, first as taxpayers and then as consumers, but does it really matter? Indeed, the CAP comes cheap: around 1% of EU public spending, he says, as against 1.5% in America.

Finally, says Mr Gaymard, it is shoddy thinking to link the CAP with the plight of third-world farmers. The EU now gives tariff-free and quota-free access to farm products (with phase-in periods for sugar, rice and bananas) from the world's 49 poorest countries. Australia's Mr Vaile may argue that this discriminates against less poor countries such as Brazil, but, replies Mr Gaymard, "Do we really need to show that the needs of Brazil, a great world industrial power, are not the same as those of Bangladesh or Mauritania?" Anyway, the EU takes 40% of Brazil's farm exports, compared with 15% taken by America.

The real trouble with third-world farming, says Mr Gaymard, is its reliance on exporting cash crops, such as coffee and cocoa, a policy that both undermines traditional farming and increases risk, as imports rise but export prices (look at coffee) may collapse. Rather than damn the CAP, poor countries should be imitating it.

Humph. But Mr Gaymard, in his Oxford speech, had a stronger point: other industrialised nations "are not ready to eliminate their support for agriculture. They have not committed themselves to doing so in international forums and do not believe that, as far as they are concerned, it would be to the developing countries' advantage. Therefore"—or so ran the conclusion he drew—"let us stop dreaming."

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Press freedom in Russia

Reading and running between the lines

Jan 9th 2003 | MOSCOW
From The Economist print edition

State pressure and business rivalries threaten to neuter Russia's media

The media and the messengers

Name	What sort	Who's behind it	Daily readership or audience*	Attitude to Kremlin
Ekho Moskvy	News radio	The state (via Gazprom-Media, run by Boris Jordan)	985,000	Critical
Gazeta.ru	News website	Mikhail Khodorkovsky, oil baron	45,000	Neutral
Izvestia	News daily	Vladimir Potanin, industry magnate	452,000	Supportive
Kommersant	News and buiness daily	Boris Berezovsky†, exiled oligarch	259,000	Wryly critical
Komsomolskaya Pravda	Tabloid daily	Vladimir Potanin	2,097,000	Supportive
Mayak	News radio	The state	6,315,000	Supportive
Moskovsky Komsomolets	Tabloid daily	Yuri Luzhkov†, mayor of Moscow	894,000	Supportive
Novaya Gazeta	News daily	Mikhail Gorbachev†	Won't say, but small and shrinking	Stongly critical on Chechnya
NTV	Television	The state (via Gazprom-Media)	30.6m	Tries to be objective
ORT	Television	The state	40.4m	Slavishly supportive
RTR	Television	The state	36.7m	Slavishly supportive
TVS	Television	Ten squabbling oligarchs	18.2m	Tries to be critical
Vedomosti	Business daily	Foreigners‡	59,000	Stolidly neutral

*For newspapers, average issue readership; for websites, unique hosts per day †Rumoured, not confirmed
‡Including Pearson, part-owner of *The Economist*

Sources: International Research & Exchanges Board; Gallup Media; SpyLOG; *The Economist*

COLLABORATE or be crushed? Editors and media bosses have always trodden a fine line between criticism and appeasement, both of the state and of the big corporations that wield power in Russia—and sometimes they have been caught in between. Now, however, their dilemma has become especially sharp: whether or not to help the state write the law that will govern them.

It stems from last year, when the Duma, the lower house of parliament, began debating amendments to the media law to restrict reporting of "anti-terrorist" events. These would include a ban on reporting "statements of people trying to stop an anti-terrorist operation". Critics feared this would be used as an excuse to strangle all coverage of the government's biggest embarrassment, the war in Chechnya.

And then, as luck would have it, just such an operation took place: the rescue of the people who had been held captive for nearly three days by Chechen rebels in a Moscow theatre. Many of the media were doing round-the-clock coverage of a big crisis for the first time. By their own admission, some overstepped the mark, and the criticism of the rescue—in which 120-plus captives died as well as the hostage-takers—also alarmed the authorities.

The changes to the media law were quickly passed. Fearing outright censorship, leading editors banded together and, at the press minister's suggestion, petitioned President Vladimir Putin to veto the amendments, promising that they would impose self-

AP

regulation. He agreed. “That looked like a big scheme,” says one news editor. It allowed Mr Putin to win the media's obedience while looking like a defender of free speech into the bargain. “I don't think there was such a crafty plan,” says Alexei Venediktov, director of the leading radio station, Ekho Moskvy, “but he certainly used the situation to display his power.”

Good news is old hat

That power was already pretty clear. Gone are the days when Vladimir Gusinsky and Boris Berezovsky, two media magnates now in exile, used their channels to launch broadsides at Mr Putin, in particular when he mishandled things after the disastrous sinking of the *Kursk* submarine in 2000. The government took advantage of financial problems at Mr Gusinsky's channel, NTV, to take it over and put Boris Jordan, an American-born banker, in charge. Mr Berezovsky's channels, ORT and TV-6, were also wrested from him: ORT is now a state pet, and TV-6 closed down a year ago after briefly sheltering most of the original NTV editorial crew.

Those survivors now try to keep the flame alive at another private channel, TVS. But it is withering under financial troubles and a struggle for control between the covens of businessmen who own it, one group of them loyal to Mr Putin, the other to Anatoly Chubais, head of the electric utility, United Energy Systems, and a political mover in his own right.

Even Mr Jordan's NTV came in for a public tongue-lashing from Mr Putin for not fully obeying Kremlin orders on broadcasting during the hostage crisis, though Mr Jordan thinks that someone, wanting to undermine him, deliberately exaggerated the channel's transgressions to the president. No wonder, then, that people like Mr Venediktov feel obliged to join the committee of journalists, MPs and officials that has been set up to write an entirely new media law. “I'm against having a new law, but one will be adopted anyway with or without me,” he says.

In theory, if done right, it could actually strengthen the media. Currently an array of other laws nip at the press's heels: from the one on elections, which bans the press from campaigning for or against candidates but does not make it clear what that means (“If I say that so-and-so is very tall, that could be construed as campaign material,” says Mr Venediktov), to a new law on the Russian language, which could theoretically be turned against media outlets for using slang or ungrammatical Russian.

Journalists on the committee want to protect the press from such attacks by including a clause giving the new media law primacy over others. But such a clause may not get through. And given the way the authorities already behave, it is doubtful what difference either the original amendments or a new media law would make in practice.

During the hostage affair, another television station was briefly closed down and a radio station was threatened with being taken off the air. Broadcast licences can be revoked after two official warnings. Raids by the FSB (the internal security service) or tax police are also common forms of pressure. As *Versiya*, a Moscow newspaper, went to press with an article questioning the official death toll after the hostage affair, the FSB took away its computer server, supposedly for something it had published five months earlier. The last time it was confiscated, after the *Kursk* sinking, it was held for six months. Rustam Arifdzhanov, *Versiya*'s editor, points out that during the hostage crisis the government did not even bother to declare a state of emergency, which would have allowed it to impose direct censorship. The strongest criticism of the government, particularly on Chechnya, still comes from a handful of fairly high-quality papers—*Novaya Gazeta*, for instance—but their circulation is small.

Many journalists think the Kremlin's obsession with control reflects its concern about the presidential election in 2004. “It is thanks to the television channels that Putin got elected and that an unknown figure became a national leader with a sky-high rating in a matter of months,” says Yevgeny Kiselyov, the TVS (and former NTV) editor-in-chief. Such an ability to manipulate opinion will be hard for Russia's leaders to give up. “I don't think Putin's attitude to the press has changed,” argues Mr Venediktov. “He still sees it as an instrument, perhaps for the attainment of very noble goals from his point of view, but an instrument all the same.”

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Lithuania's presidential election

Stunt man wins

Jan 9th 2003
From The Economist print edition

A surprise defeat for Lithuania's establishment politicians is healthy

TIME was when having a sharp English-speaking president was a big plus for a small ex-communist country wanting to join the continent's best clubs. Now it matters a lot less. So last week's run-off presidential election in Lithuania, where the émigré incumbent, Valdas Adamkus, lost to Rolandas Paksas, a home-grown populist challenger, will not do much damage to the country's foreign policy. Like its Baltic neighbours Latvia and Estonia, Lithuania has been invited into NATO, and is also heading for membership of the EU.

Other aspects of the election counted for more. For all his integrity and sophistication, Mr Adamkus, once a civil servant in Chicago, had been ineffective at home. He looked tired and was often ill; his team was weak. His anti-corruption chief—a presidential appointment—was a particular disappointment. His defeat is a salutary shock for the country's complacent and inward-looking political elite, which backed him solidly.

Mr Paksas' slick, well-financed campaign focused on poverty, corruption and bad government. He drew a lot of support from Lithuania's large rural population, which has done poorly in the past ten years, by promising higher pensions and lower taxes—no matter that they are the government's responsibility, not the president's. Mr Paksas was a competent mayor of Vilnius, the capital, and served twice as prime minister, both times to little effect.

His main claim to fame is stunt-piloting, a skill he displayed eagerly in the campaign, on one occasion flying under a Vilnius bridge. It will be hard for him to wow foreign audiences, though. His only fluent foreign language is Russian, and he lacks the intellect of his colleagues in next-door countries, such as Latvia's steely Vaira Vike-Freiberga or Poland's suave Alexander Kwasniewski.

His team looks flaky too. His biggest declared financial backer was a helicopter company, maybe Russian-owned, that has been accused of selling to Sudan in defiance of international sanctions (though the company says it has broken no Lithuanian law). And there are the usual rumours of Russian money sloshing around Lithuanian politics. But now that the country's biggest industrial installation, an oil refinery, is in Russian hands, the arguments about who should own what have rather died down.

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Charlemagne

A grudge match

Jan 9th 2003
From The Economist print edition

Why are Israelis and Europeans getting on so badly?

IN THE aftermath of the latest suicide bombing in Tel Aviv (see article), European leaders issued the usual denunciations of terror. Speaking for the European Commission in Brussels, Chris Patten called the attacks “appalling and wicked”. Similar sentiments were expressed in London, Paris and Berlin. Yet, somehow, within a few hours, these expressions of sympathy had given way to a rancorous dispute between the Israelis and the Europeans. The immediate cause was the decision by Israel's government to respond to the bombs by refusing to let members of the Palestinian Authority, an embryonic self-governing body in the area under Israel's control, travel to London for a conference run by Britain's prime minister, Tony Blair. Though the British staunchly support America over Iraq, they have always been careful to stress that, unlike the Americans, they see an urgent renewed effort to settle the Palestinian problem as integral to the war against terror. Mr Blair sincerely believes this. But it is also politically important for him to show Britons—and any remaining Arab allies—that Britain is not simply America's poodle and is as willing to promote peace in Palestine as to wage war in Iraq.

The British were distinctly peeved by Israel's decision to cancel the invitations to the Palestinians to come to Mr Blair's party. Details of a bad-tempered exchange between Jack Straw, the British foreign secretary, and Benjamin Netanyahu, his Israeli counterpart, swiftly leaked. Menzies Campbell, foreign-affairs spokesman for Britain's Liberal Democrats, gave a fair summary of received liberal wisdom in Europe when he commented that the Israeli ban was “wholly misguided and unnecessarily provocative. The lesson that will once again be drawn in Middle East capitals is that Israel, so long as it has the tacit support of the United States, can simply do what it likes.” Israeli diplomats respond that such reactions are not just unfair but also dangerous. “Terrorists murder people in Tel Aviv”, says one, “and within a few hours a huge row has broken out between Israel and Europe. That must be rather encouraging to the terrorists.”

The row between the British and the Israelis fits a pattern. Just as it is axiomatic for most Arabs and Palestinians that the United States is irredeemably biased against them, so many Israelis now regard European policy in the same light. Mr Netanyahu routinely accuses the Europeans of coddling terrorists. More surprising is the bitterness about European attitudes now expressed by Israelis on the left as on the right—witness a recent conference on Israeli-European relations in Berlin. One participant, Shlomo Avineri, who until recently ran an institute for European studies at the Hebrew University of Jerusalem, accuses the Europeans of double standards. Israelis, he says, are attacked for human-rights abuses, while the persecution of dissidents in Arab countries goes virtually unreported. Opinion polls certainly show that most Europeans hold Israel in low regard. A recent survey by the Chicago Council on Foreign Relations, in which American and European respondents were asked to rate their feelings towards countries on a scale of one to 100, found that Americans gave Israel an average of 55, while Europeans gave it only 38—not that much more than Iraq, which got 25.

A popular Israeli (and American neo-conservative) explanation is that “the continent of the Holocaust” is still gripped by anti-Semitism. It is true there has been a rise in attacks on synagogues in Europe over the past year, but almost all of these were perpetrated by militant young Muslim immigrants. For the average European diplomat or journalist, expressing anti-Semitic sentiment is about as socially acceptable as spitting on the boss's carpet. The real reason for the clashes between Europeans and Israelis lies elsewhere. The mainstream European assumption, expressed both in the press and in diplomacy, is that the source of the Middle East problem is an injustice done to the Palestinians, starting with the creation of refugees in 1948, continuing with the occupation of territories in 1967 and now exacerbated by Israel's settlements in the West Bank and by the violent suppression of the Palestinian uprising.

But most Israelis—at least to judge by the leaders they elect—reject the argument that all they have to

do to secure peace is to agree to a Palestinian state. They believe that “land for peace” was offered to the Palestinians at the Camp David talks sponsored by President Bill Clinton—and was rejected in favour of terrorism. By pressing Israel to make concessions now, they argue, the Europeans are rewarding terror and endangering Israel.

As bleak as it gets

Does the growing gulf between Israelis and Europeans spike European ambitions to be peacemakers? Not necessarily. One popular line of argument is that peace might arise if the Americans squeeze the Israelis and the Europeans “deliver” the Palestinians. Just before Christmas, the Europeans and Americans (along with the Russians and the UN) agreed on a still unpublished “road map” for peace, which foresees the establishment of a Palestinian state within three years. Formally speaking, at least, the Europeans and Americans agree on the way ahead. European diplomats note that the last big effort to secure a Middle East peace took place after the first Gulf war. Perhaps a second defeat of Saddam Hussein might herald a new joint European-American push for peace?

Alas, that is far too blithe. Since Yasser Arafat himself seems unable or unwilling to effect a unified Palestinian commitment to peace, it seems implausible that European diplomats might achieve it. For their part, American officials argue that the Europeans overestimate the United States' ability to deliver Israel. In truth, these grim realities are acknowledged by some of Europe's top policymakers in the Middle East. One Brussels-based diplomat says he began the new year by sitting down to write a paper on “prospects for peace in 2003”. After struggling in vain for an hour, he decided to do something more useful.

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London's economy

Metropolitan gloom

Jan 9th 2003
From The Economist print edition

Magnum

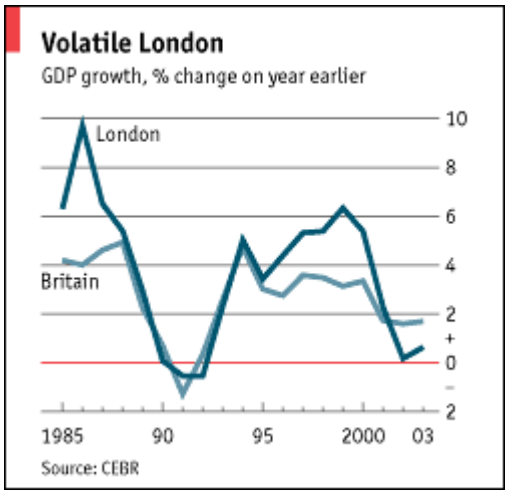
London's economy is in, or near, recession. Schadenfreude aside, that's bad news for the rest of Britain

OVER the past ten years, London has boomed. The metropolitan economy—larger than that of several European states—has out-performed the rest of the British economy by a long way. But signs are multiplying that the London economy is flirting with recession.

Official figures are no help in judging the state of the economy of different regions: the latest ones are for 1999. So assessments of the state of London's economy must rely on more impressionistic evidence, such as sectoral studies, consultants' reports, transport statistics and the wailing of bankers.

A quarterly survey of the financial services sector published this week confirms that the City is steeped in gloom. In the final three months of 2002, financial services suffered the biggest drop in activity for ten years, according to the Confederation of British Industry (CBI). It also found that only 9% of financial-services firms were planning to increase employment over the next three months whereas 43% were planning job cuts. That suggests that another 20,000 financial services jobs will go in 2003.

Things are not much better in the business services sector (IT services, consultancy, law and advertising) that looms large in London's economy. According to CEBR, an economic consultancy, the number of jobs in business and financial services in London grew by 45,000 a year between 1993 and 2001; since then they have fallen by 20,000.



The weakness of London's labour market is beginning to show up way beyond the borders of the City. Over the year to September 2002, employment fell as a share of the working-age population in London whereas it rose across Britain. A CBI survey of manufacturing—which still accounts for a tenth of GDP and 7% of employee jobs in London—found that employment prospects there and in the south-east were the worst in the country. According to a survey of overall employment by Manpower, a recruitment agency, job prospects in the capital are now second worst in Britain. This is very unusual: over the past 30 years job prospects in London have generally been among the best in the country because of the city's diverse and skilled

workforce.

A good guide to overall economic activity in the capital is the number of journeys that people are making on the tube and rail networks serving London. In the five financial years to 2000-01, journeys on the tube and mainline rail services rose by 4-5% a year. But in 2001-02, the number of tube journeys fell by 2%; those on mainline rail fell slightly. More recently, passenger numbers have been stagnating on both the underground and mainline rail services into London.

According to CEBR, the capital is currently close to recession. Douglas McWilliams, its chief executive, says that the three bulwarks of the London economy are business services, financial services and tourism. “The thing that's hit London is that all three have gone wrong at the same time.” As a result, CEBR calculates that output in the capital is currently shrinking, and that year-on-year growth will be 0.7% in the whole of 2003 after a miserable 0.2% in 2002.

Mr McWilliams does not believe that London will fully recover until 2005. The main reason is that the City—historically the dynamo of the London economy—will act as a drag on growth. In the past two decades, the City has thrived on the back of booming world stockmarkets and international financial activity. But after the worst bear market since the 1930s, stockmarkets will remain subdued. And international financial activity will remain sluggish for some time because multinationals are not, in general, indulging in the global empire-building that gave the City so much work in the good times.

The City—historically the dynamo of the London economy—will act as a drag on growth

The capital's troubles are bound to be felt around the country. Over the past decade, London's economic dominance has become even more pronounced. It now produces 17.5% of Britain's GDP. Its influence is felt through a number of channels. Commuters who work in London spend money in the surrounding regions where they live, for instance, and London-based businesses and residents also purchase goods and services from the rest of the country. So, while London doesn't pay much attention to Birmingham's suffering when manufacturing industry is doing especially badly, Birmingham will feel London's pain.

Probably the most important channel from London's prosperity to the wider national economy in the past few years has been house prices. House prices boomed first in London. Rising property prices then rippled out to the rest of the country. But house prices are now falling in some parts of London, especially at the top end of the market. Declining house prices in the capital foreshadow a weakening housing market in the rest of Britain.

London also matters to the rest of the country because it produces so much of the country's tax revenue, which is redistributed to the regions through public spending and transfers. The Treasury's sums have already gone awry largely because the City's weakness has hit profits and cut the number of high earners.

A period of slack growth in London will help relieve the pressures of overcrowded tubes and overpriced housing. It will also reduce some of the regional polarities in the country. But growth lost in London is not generally redistributed to the rest of the country, so a weak London economy means a less dynamic British economy, argues Mr McWilliams.

A lull in growth could hurt London itself in the long term as well as the short term. London has succeeded despite a poor transport system; if it is to thrive in the future, it needs a better one. But the danger is that, when the pressure is off, everybody forgets about the need for new investment; and then, next time round, the chaos is even worse.

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Terror

Bean there

Jan 9th 2003
From The Economist print edition

A plot foiled. What next?

HOW much did they make? What was it for? Where is it now? The arrests of six Algerian men and one Ethiopian, and the discovery of a smidgen of ricin, a lethal poison, in a flat in north London this week, leave these three unsettling questions unanswered.

Ricin is derived from castor beans using a simple chemical process involving easily obtainable materials, chiefly lye, acetone, a coffee grinder and some old newspapers. Instructions are available within seconds from internet sites. There is no antidote, and a milligram—less than a grain of salt—is fatal. Documents found after the fall of the Taliban in Afghanistan show that al-Qaeda had investigated ricin, among other poisons.

It could be worse—anthrax, say. Ricin is more suited to assassination than mass murder. It was used to kill Georgi Markov, an émigré Bulgarian, in London in 1978. But spraying it in the underground or dumping it in a reservoir would still cause a fearful commotion. The government is telling all hospitals to watch out for the flu-like early symptoms of ricin poisoning.

The other good news, such as it is, is that the authorities are evidently having some luck in hunting terrorists before they strike. The latest raid in London is probably a result of another success: the discovery last month of false papers, protection suits, and chemicals suitable for bombmaking in a flat in Paris, where four North Africans were arrested. The next week, seven more men were arrested in Britain.

That operational success contrasts with the government's muddled propaganda campaign, which is failing in the admittedly tough task of encouraging alertness while discouraging panic. Last month the Home Office issued a warning that a nuclear or chemical attack by terrorists was likely, but then toned it down within hours.

The government is also planning new laws to update the country's disaster planning, which is currently a cluttered mixture of cold-war relics and ad hoc measures introduced since September 11th 2001. But all the planning and propaganda in the world will not change the underlying fact: there are a lot of people around who are willing and able to mount terrorist attacks. Only a handful of them need to succeed for something horrible to happen.

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Rich foreigners

Why they all love London

Jan 9th 2003
From The Economist print edition

Will Gordon Brown dare to scare rich foreigners away?

THERE are many reasons why London is an attractive place in which to live and to do international business: the time zone, English, the shops, the theatre—and the taxes. A loophole in Britain's law allows many foreigners to avoid paying tax on income generated outside Britain or on the disposal of foreign assets.

In most countries, a foreign resident's “domicile” (home country) status is determined by objective criteria. In Britain, it's largely up to the foreigner. So a Greek shipowner who has lived in Britain for years but says that he intends to move back to Athens when circumstances permit is treated differently from one who says he intends to settle in Britain.

This rule helps explain why so many rich foreigners choose to live in a city with such rotten weather and congested roads. At least 60,000 are reckoned to benefit from the loophole; and their considerable investments in the better streets of Belgravia, Mayfair and Hampstead have injected many millions into the top end of the property market. If they pulled out, nasty things could happen to the price of penthouses. So there has been considerable alarm in monied circles since Gordon Brown declared that he was going to review the rules in last April's budget. The review is expected this year.

It is easy to understand why a Labour chancellor would want to close a loophole that turns Britain into a tax haven for rich foreigners. And it isn't just politicians who disapprove. “Every tax system treats temporary residents differently. What is ridiculous about this system is this archaic, subjective rule about domicile,” says Edward Troup of Simmons & Simmons, a City law firm.

But there are worries that if the government removes this tax loophole, London will suffer. The change will affect not just rich shipping magnates but foreign staff working for London's international banks. “Whenever governments have looked at this in the past 20 years, they have concluded that the balance of advantages was in favour of leaving the rules as they are,” says John Battersby, a tax partner at KPMG, an accountancy firm. “There isn't any easy money for the government because a lot of the people are internationally mobile and won't stay.”

So far, the Treasury appears inclined to caution. In the November pre-budget report, it stressed the need to balance tax fairness with the ability to attract skilled labour. But rich foreigners are keeping a close eye on the promised review.

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North-east

Boom on the Tyne

Jan 9th 2003 | NEWCASTLE-UPON-TYNE
From The Economist print edition

While London suffers, the Tyne's shipyards have come back to life

WHEN the south of Britain catches a cold, the north usually gets pneumonia. That doesn't seem to be happening just now. In the past year, while unemployment in London and the south-east has started to rise, it has continued to fall in the north-east. Manufacturing firms in the region are a lot chirpier than they have been for some time. One of the main reasons is the growth in defence spending which, apart from swelling a lot of engineering order books, has brought ship-building back to the Tyne and looks like keeping it going for the next two decades.

Nobody in the north-east is crowing just yet. The regional economy is still suffering the occasional knock: last year, Black & Decker, a toolmaker, shut its County Durham factory with the loss of 1,000 jobs. Blows like this, some by firms shifting production to cheaper locations such as eastern Europe, are reckoned by the GMB trade union to have cost something like 4,800 manufacturing jobs in the region in 2002.

So it seems surprising that the regional unemployment claimant count fell from 5.4% to 4.8% in the year to November 2002. That, says Keith Burge, managing director of Economic Research Services, a Newcastle-based consultancy, is mainly because a lot of lost jobs have been mopped up by the expanding service sector, historically under-represented in the north-east.

Yet engineering and shipbuilding, written off a decade ago as sunset industries, also seem to be enjoying a new dawn. The most recent survey of British engineering showed that firms in the north-east were about the only ones in the country whose output was rising. Alan Hall, regional director of the Engineering Employers' Federation, says that is partly because of the booming construction industry; but defence procurement is also helping, most strikingly in Tyneside shipbuilding. Swan Hunter, which closed in 1994 and reopened a year later after Jaap Kroese, a Dutchman, bought it for £5m ($7.9m), was kept going with ship conversion work. Last year, after Mr Kroese spent £26m on re-equipping the yard, it won a £136m order from the Ministry of Defence (MoD) to build 16,000-tonne troop and equipment-landing ships.

The big prize is a slice of an MoD order for two 50,000-tonne aircraft carriers. Next month, the MoD is due to decide whether Thales, a French consortium, or BAe Systems is the lead contractor for the £2.7 billion job. Irrespective of who wins, Swan Hunter expects to get 35-40% of the work. While the ships are due for delivery in 2012 and 2015, further contracts for outfitting and improvements, reckoned to be worth about £7 billion, could keep the yard busy until 2019.

This renaissance has been engineered partly by vastly improved labour relations. The wildcat strikes which used to hit the Tyne shipyards with monotonous regularity are gone. That's one reason why AMEC, a construction

The wildcat strikes which

firm, won a £300m contract from Shell to fit out a 300,000-tonne oil production and storage ship, the Bonga, whose red hull now towers out of the firm's Wallsend yard. A share in the work gained by an adjacent yard, McNulty Offshore, helped its management to buy the yard when its French owners decided to sell it last year. The GMB trade union says that, in the 1990s, there were a few hundred people working in shipbuilding on the Tyne. There are now about 5,000.

used to hit the Tyne shipyards with monotonous regularity are gone

Shipbuilders and suppliers work more closely together than they used to. Such collaboration helps ensure that the benefits of big contracts spread to firms throughout the region. “We can source locally everything from computer systems down to nuts and bolts and fire extinguishers,” says Norman Brownell, Swan Hunter's commercial director.

Around 100 firms in the region working in other defence-related areas have formed the Northern Defence Industries association. Co-operation between seven firms last year helped them win £50m of work on a government contract for infantry anti-armour weapons awarded to Saab Bofors Dynamics.

The one thing the defence manufacturers don't want, oddly enough, is a war with Iraq. Keith Hayward, head of research at the Society of British Aerospace Companies, says that companies are benefiting from a procurement bulge rather than a war dividend. If there is a war, says Mr Hayward, the MoD will spend its money on bombs, bullets and keeping troops overseas. Big procurement contracts, such as the aircraft carriers, will be put on hold until the dust settles.

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House of Commons

Time, gentlemen!

Jan 9th 2003
From The Economist print edition

From this week, MPs are to work normal hours. Will anything be lost?

OTHER than during the second world war, when German bombers rudely interrupted proceedings, the last big change in the way of the House of Commons operated was triggered by the introduction of gas lighting. Reliable illumination meant that debates could start later and carry on long into the night. At a time when nearly all MPs had other jobs, and fathers (they were all men) were not expected to play a role in bringing up young children, this was deemed eminently sensible. But no longer.

This week, largely thanks to Robin Cook, the reforming Leader of the House, Britain's legislature turned itself into something like a normal workplace. Only on Mondays (to allow MPs to return to London from far-flung constituencies) will debates be allowed to continue into the late evening. On the following three days, the chamber will clock off no later than 7pm, while on Friday (so that MPs can depart in good time to their constituencies), everyone will be off by 2.30pm. There will also be a shorter summer break that will begin in early July and coincide exactly with school holidays.

Among traditionalists, there's a certain amount of spluttering at this radicalism. That's partly because the changes have been driven by two of the aspects of New Labour most disliked by both Old Labour and the Tories: Blair's babes and the spin machine.

These new arrangements are designed in part to accommodate rather better the lives of today's MPs, many more of whom are youngish women and nearly all of whom are now full-time politicians. They are also intended to make it easier for the media to report what happens in the Commons. Prime minister's question time will now take place before the lunchtime news on Wednesday and ministerial statements on big issues will be at 12.30pm instead of 3.30pm or later.

Nobody really knows what effect this will have on the old place. Some believe that the clubbiness of the Commons, with its many bars and pleasant dining rooms, has been integral to way it has worked. They fear that without evening sittings, and the social drinking that went with them, MPs' lives will get lonelier. Instead of bonding with party colleagues and making often surprising friendships with political opponents, they will skulk off the moment the factory whistle blows. For those who have homes to go to, well and good. But for many MPs, whose families live in constituencies far from London and who have only bleak bedsits to return to, the temptations of the bottle or an illicit affair will increase.

Never mind, say the modernisers, such as the famously unclubbable Mr Cook. What matters is that MPs will be able to work more efficiently.

Probably they will, at least in part because the chamber will almost certainly become less of bear-pit. Debates, without the fuel of alcohol and the drama that night seems to bring, will be more earnest and less volatile. Oh dear. Does politics really need to be made any less exciting than it already is?

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Criminal justice

Hard cop, soft cop

Jan 9th 2003
From The Economist print edition

Why the government's sentencing policy is so confused

Get article background

THIS week, as figures came out suggesting that gun crime had risen by a fifth over the past year, the home secretary, David Blunkett, proposed a mandatory five-year sentence for anyone caught with an illegal firearm. Three weeks ago, the Lord Chief Justice, Lord Woolf, set out new sentencing guidelines which mean that most of those convicted of burglary in future will not go to jail—a decision which sits oddly with the introduction, in 1997, of mandatory three-year sentences for persistent burglars. If villains as well as voters were left confused by these alternating hard cop, soft cop messages, it would not be surprising.

The police are furious about the softening of policy towards burglars. Sir David Philips, president of the Association of Chief Police Officers, in a rare criticism of the government, said the change in sentencing policy would “strike fear” among householders and would undermine police morale.

There's a good argument for keeping some burglars out of jail. As a white paper on crime argued ten years ago, prison can simply be “an expensive way of making bad people worse”. Reconviction rates among burglars are the same for those imprisoned and those punished outside jail.

This is a perfectly reasonable defence of the policy; but it is not the reason for it. The Lord Chancellor, Lord Irvine, admitted this week that policy was being determined by the desperate state of the prisons. The current record jail population of nearly 73,000 was “insupportable”, he said. The government estimates that on current trends, the prison population will grow by at least 25%—to nearly 100,000, in other words—and possibly by as much as 50% over the next seven years.

Pressure on prisons has been getting worse for years. An official audit of prison resources published in July 1997 said that overcrowding made it impossible to maintain “adequate levels” of constructive activities for prisoners. Since then the position has worsened. More than half of the 140 prisons in England and Wales are now seriously overcrowded.

More than half of the 140 prisons in England and Wales are now seriously overcrowded

If prisons are so overcrowded, why are more not being built? Currently only two new prisons are planned; they will house an additional 1,300 prisoners.

Building prisons, of course, costs money. And unless there is a riot, prison overcrowding does the government no harm in the short term. Nobody minds if prisoners complain. In the long run, though, it ensures that prison doesn't work, because the greater the strain on prisons, the less chance they have of putting prisoners through the sorts of programmes that help reduce recidivism. Last year, the Prison Service failed to meet half of its targets for work and training.

Home Office research suggests that family support can reduce a prisoner's risk of re-offending by as much as six times. But overcrowding means that prisoners have to be locked up wherever a place can be found for them, so more than half of all prisoners are held more than 50 miles away from where they were sentenced.

As well as the practical questions, there is a moral one—of whether a civilised country should treat its prisoners as Britain does. The director-general of the prison service, Martin Narey, has said that he is ashamed of “the immorality of our treatment of some prisoners and the degradation of some establishments”.

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Black boys

Taking the rap

Jan 9th 2003
From The Economist print edition

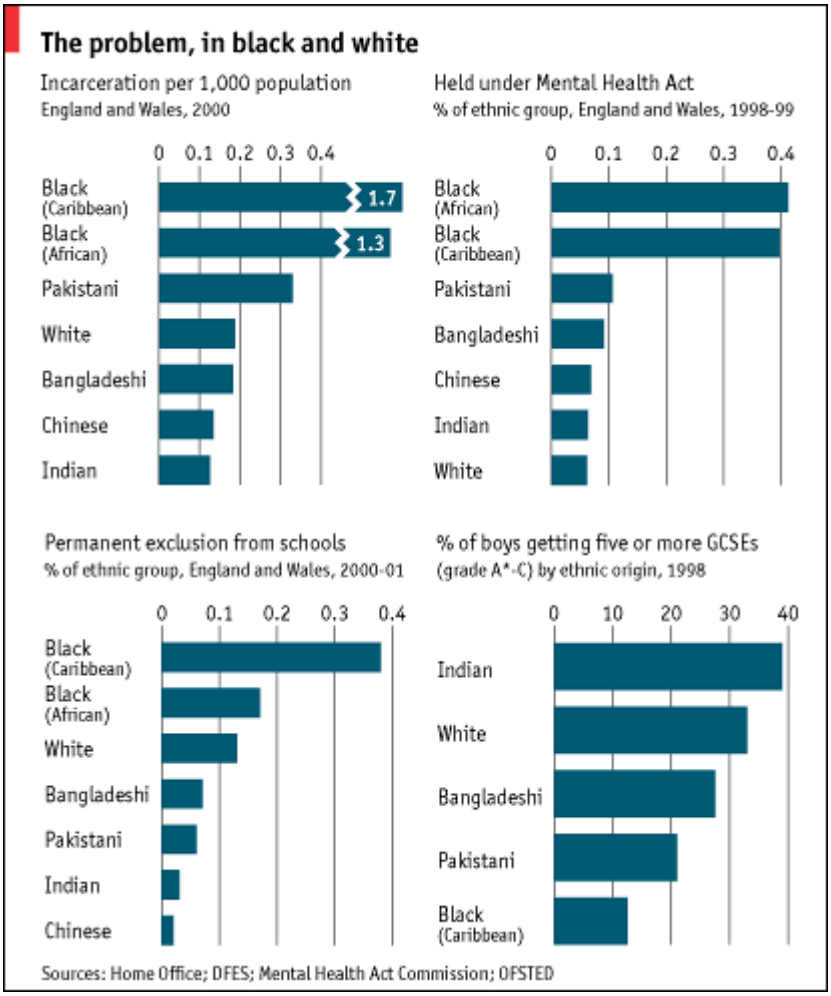
The government is at last starting to try to deal with the huge problems among West Indian boys

Get article background

LAST week two black teenage girls were killed in a burst of gunfire outside a party at a Birmingham hairdressing salon. Two others were injured. Police think the killers were gang members from the same West Indian community as their victims. In the immediate aftermath of the murders, both the home secretary, David Blunkett, and the culture minister, Kim Howells, suggested that the violent imagery of rap lyrics had helped foster a culture in which firearms have become fashion accessories; but the problems go far wider, and deeper, than rap.

That black boys (especially those of West Indian origin) do worse at school, and are likelier to be excluded, jailed, unemployed and suffer mental illness is not news. (Africans do better at school; West Indian girls do fine.) But it's a subject which politicians have always had difficulty talking about, because they fear that talking about race makes them sound racist. Recently, however, that has been changing.

The scale of the problem is horrifying (see charts), particularly given that black West Indians start off at primary school with better literacy and numeracy skills than any other ethnic group. How to explain this depressing trajectory? “This is still a question which courts a lot of controversy,” says Marian FitzGerald of the London School of Economics. “It is complex and politically sensitive. Nobody wants to be seen to be ‘explaining away' discrimination.” Broadly speaking, opinion divides between those who blame racism among whites, and those who think there's something bad going wrong in the culture that black boys are brought up in.



As far as school performance is concerned, proponents of the racism view reckon that many teachers (the majority of whom are white and, at primary schools, female) see black boys as lazy, aggressive and disruptive. If teachers' expectations start low, they can be self-fulfilling.

Others insist that the anti-education culture in which many of these children are now raised also plays a big part. At a recent teachers' conference, Tony Sewell, a (black) education consultant, presented the results of his survey of a cross-section of 15-year-old black pupils in schools in different parts of the country: 80% of participants said they felt the main reason they were not doing well was not racism among teachers, but peer pressure.

West Indian boys, Mr Sewell found, often regard comforming to school discipline as a betrayal of their peer group. Hard workers are mocked as uncool and accused of “acting white”.

This kind of thinking is reinforced by potent media stereotypes and by rap. “It's an image thing,” one boy told Mr Sewell. “Black kids are just acting out what they see on television and read in magazines. I know I've done it.” To counter such perceptions, Mr Sewell has been piloting a course in inner-city schools on how to handle disputes and resist peer pressure.

The government's many policies addressing social exclusion have tended to be resolutely colour blind. “When Labour came to power in 1997, the tendency was to downplay problems that particular ethnic-minority groups faced and to adopt policies to combat deprivation generally,” says Andrew Pilkington of University College, Northampton. Thinking changed in 1999, following the Macpherson report into the bungled investigation of Stephen Lawrence's murder, which showed up racism among the police. One consequence has been a (so far unsuccessful) campaign to get more black people to join the police.

As well as trying to look less racist, the police are now targeting black problems. The Metropolitan Police's Operation Trident aims to get guns out of London's black communities, which have seen the worst of drug-related shootings. The streets in black areas such as Brixton are covered in posters asking blacks to give information about people with guns.

Now the education department is developing a national strategy to address the underachievement of pupils from particular ethnic groups, including West Indians. More will be revealed in the spring.

Whatever the details of the plan, the chances that it will make much difference are, inevitably, limited; but at least the government is no longer too embarrassed to talk about the problem.

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Bagehot

Labour's London problem

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The capital's failing public services may cost the government dear

IF IT weren't for London, would the government really think it so important to ladle so much money into the public services? To be sure, there are run-down hospitals, poorly-performing schools and traffic jams in other ill-favoured corners of Britain, though nowhere are they so numerous or so dreadful as in the capital. But across most of the country, people are surprisingly satisfied with their health care and their children's education. Opinion pollsters consistently find that the personal experience of individuals (outside London) is at odds with the general perception that public services are falling apart.

It may be that people are fairly happy with public services partly because they didn't expect a great deal. But it is at least possible that the crisis the government is so expensively trying to fix is largely one of perception that springs from the exceptional problems of London.

It is easy to see how this might have come about. Even if the school you send your own children to is a pleasant, orderly and comparatively well-run place, if you read newspapers or watch television you will quickly come to believe that you are a rare and fortunate exception. This is not because the media is wilfully distorting the truth; it is because the people who work for it live almost exclusively in London and share the experiences of other Londoners. If you regularly suffer the indignities of travelling on London's filthy, over-crowded underground; if you have ever found yourself amidst the terrifying chaos of the accident and emergency department in any of London's dirty, under-staffed hospitals; or if you have felt forced to make huge financial sacrifice to preserve a child from one of London's anarchic and education-free inner-city schools, you are quite likely to be both livid about the state of public services and sceptical about government claims to be making things better.

The government knows this and is worried about it. Its worst nightmare is that after five years of heroic spending, the perception of public-service failure is unchanged. It comforts itself by saying that what matters is that people experience an improving reality in their daily lives. But why should the future be different from the past? Unless those improvements are also felt by Londoners (and by extension, the people who write and comment about these things), that all-important perception will be hard to change. Which makes the government's apparent indifference to the plight of London as hard to understand as it is shocking.

Although London needs a better transport system, building more railways and improving the underground will take years. But the state of many of London's public services can be more easily addressed. While the high levels of poverty and immigration that make public services harder and more expensive to deliver in the capital cannot be wished away, the other main reason why London's schools and hospitals have such problems could be swiftly tackled: the pay of public-sector workers is too low to attract and retain enough good people.

Housing costs in London are 80% higher than the average in Britain, and travel—and everything else—costs more. Average salaries in the private sector in London are more than 40% higher than in most of the rest of the country, so Londoners working in the private sector end up with about as much disposable income as people elsewhere. But public-sector workers' pay varies little around the country save for a couple of thousand pounds in “London weighting”. For them—particularly the low-paid majority—the situation is desperate.

Public-sector workers' pay varies little around the country. For them, the situation is desperate

Predictably, most of the militancy behind the firemen's demands has come from union branches in London. Although their union's 40% pay claim is absurd if applied nationally, it is less ridiculous in a London context. Indeed, even

allowing for relatively generous public-sector pension arrangements and job security, public-sector pay in London may need to rise by as much as 30% if recruitment issues are to be tackled.

In the meantime, London's schools and hospitals will continue to depend upon an army of foreign workers on short-term contracts, many without proper qualifications or, sometimes, much command of English. Some, like the young Australians and South Africans who fill many temporary teaching and nursing jobs, are prepared to put up with sordid living conditions because they know they are just “passing through”; others, because they have escaped from still worse poverty at home. Without these people the situation would be far worse than it is, but organisations need stable, well-trained workforces if they are to have any hope of operating efficiently.

A great sucking sound

London is easily rich enough to pay its public-sector workers decent wages, but it isn't allowed to. The government, which gathers 96% of tax centrally, uses the capital's wealth to subsidise other parts of the country where the quality of public services is already far better. London's net subsidy to the rest of the country is £10 billion ($16 billion) to £20 billion, according to Tony Travers, director of the Greater London Group at the London School of Economics. That will increase once the new local-government bill, which had its second reading this week, becomes law. And a property revaluation promised in the next year or two (which will mean higher taxes for those whose properties have gained more in value) will penalise London further.

With only two London MPs (Tessa Jowell and Paul Boateng) in the cabinet compared with five Scottish heavy hitters (Gordon Brown among them), it is not surprising that London has trouble getting heard. But if the prime minister is right to describe good public services as “socialism in action”, it is odd that he and his egalitarian chancellor seem to care so little for London's plight. It will serve them right if the “London problem” comes back to haunt them.

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Corporate finance

The dividend puzzle

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Is it time to revive the popularity of dividends—and are tax cuts the way to do it?

UNTIL recently there was much talk of the impending death of dividends. But a confluence of events has conspired of late to make bosses and investors think again. Stockmarkets have sagged, making investors notice the minimal amounts of cash they were earning from their shares. Investors have grown more sceptical about accounting profits in the wake of Enron and WorldCom and now wonder if evidence of profitability in the form of a dividend cheque might help them to sleep more easily. Some big firms have piled up so much cash that it seems to burn a hole in their pockets. Even George Bush is trying to boost the popularity of dividends, by proposing to scrap income-taxes on them.

The now passing unfashionability of dividends was always most pronounced in America, where over the past 20 years technology firms have seized on the idea that their growth opportunities were so glorious that paying a dividend would indicate weakness, telling investors that they could not find profitable ways to use the money. As a result, maturing technology firms have come to own large cash piles: Microsoft has $40 billion, Cisco $10 billion and Dell $4 billion, for example. One of Europe's cash hoarders is Nokia, with over *euro*8 billion ($8.3 billion).

To be fair, not all of the decline in the popularity of dividends reflected a fall in payouts by firms to shareholders. In the past decade, there was also a sharp increase in firms returning surplus cash to shareholders by buying back their shares, instead of through dividends.

The way dividends are taxed can have wide-ranging consequences for how a firm is run

The declining role of dividends was encouraged by the theories of academics, many of whom instructed today's top managers in business school. One Nobel-prize-winning theory suggested that whether or not a firm paid a dividend should make no difference to the value of a firm to investors. According to this “irrelevance theory”, every share's value is based on the future cashflows from a company; it does not matter one whit whether those cashflows are paid out in dividends or kept as cash on hand by the firm. Shareholders receive the value of those cashflows either way—through dividends if paid, through a higher share price if not. Many bosses concluded that if they did not have to pay a dividend, why do so?

Admittedly, not all academics agreed that dividends were irrelevant, either in theory or in practice—but such quibbles were largely ignored so long as shareholders were reaping capital gains in the bull market for shares. For instance, it had long been observed that a firm's share price tended to fall if a firm cut its

dividend. More recently, some technology firms have seen their shares suffer when they have announced a plan to pay dividends.

To explain this breach of irrelevance theory, academics have made several suggestions. Perhaps dividends send a signal to investors: not paying one means that you have great growth opportunities; starting to pay, that your opportunities are declining; cutting an existing dividend, serious financial troubles. Anyway the bubble in American share prices in the 1990s has led some academics to ask if the markets can be relied upon to think rationally about anything, including dividends.

But in the real world there remains one overwhelming reason why dividend policy is not irrelevant: tax. The way dividends are taxed can have wide-ranging consequences for how a firm is run. In particular, it can influence whether a firm finances itself primarily through equity or debt, and how it chooses to return profits to its shareholders.

The tax factor

Taxes may largely explain the growing popularity of share buybacks compared with dividends in recent years. Buybacks are, in theory, just another way to return cash to shareholders, by buying up shares on the open market and retiring them. The reduction in the number of shares outstanding means that profits are spread over a smaller base of shares, which should lift share prices for investors who do not sell them back to the firm. The firm may be indifferent between dividends and buybacks as a means of distributing profits, but many investors are not. In America and many other countries, dividends received by investors are taxed at a higher rate than capital gains, such as those created by share repurchases.

In most countries, tax rules allow firms to treat interest payments on debt as a tax-deductible expense, whereas cash payments to equity holders in the form of dividends or share repurchases come out of after-tax income. All else being equal, therefore, the tax system typically makes debt a cheaper source of finance for a firm, at the margin, than equity. As bosses caught on to debt's tax advantages, borrowing soared in the 1980s and 1990s—though some firms got carried away, took on too much debt and went bust. This was particularly true during the leveraged-buy-out (LBO) craze of the late 1980s.

In recent years, governments almost everywhere have become increasingly concerned about the impact of taxation on companies. By and large, they have favoured tax reforms that are intended to boost business activity, such as cutting marginal tax rates—though in practice their reforms have often had unpredictable results. For example, in 1997 Britain ended all tax exemptions for dividends, ostensibly to encourage reinvestment of profits by firms—precisely the opposite of Mr Bush's current plan—but there is no evidence that it achieved this aim, according to the Institute for Fiscal Studies in London.

Some possible consequences of Mr Bush's plan, if it is implemented, include above all making it more attractive for savers to invest in shares relative to other financial instruments. Although this may have unintended bad consequences for other capital raisers—notably municipalities, which have relied on a tax exemption on interest payments for their appeal—the jump in the supply of equity capital should reduce the relative cost advantage to firms of using debt rather than equity.

Removing the tax disadvantage of paying dividends may force managers to find other plausible excuses for holding on to cash—or else to pay it out. This may make it harder for them to squander cash on ill-advised ventures such as, say, Microsoft's costly move into cable television. If it becomes the norm for most firms to pay out a large chunk of their profits as dividends, companies posting fake results might not get away with it for as long.

Yet the Bush plan does not go far enough in removing tax as a force in the corporate boardroom. A better solution would be to make dividends a tax-deductible expense for companies, just like interest payments, so as to establish full tax-neutrality between debt and equity.

An even bolder way to end the distortions caused to firms' behaviour by tax might be to scrap corporate tax altogether. That need not, as critics suggest, mean that corporate profits go untaxed. Rather, they could be taxed when the profits are received by shareholders who own the firm, whether as dividends (which would no longer need to be tax-exempt for investors, as Mr Bush now intends) or as capital gains. Alas, judging by the political storm over Mr Bush's dividend plan, voters are not yet ready for such boldness.

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Home Depot

A do-it-yourself disaster

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AP

Is America's DIY retail giant in crisis?

IN A country in which even such all-male preserves as the Augusta National Golf Club are under threat from female invasion, the Home Depot, a giant DIY chain, offers sanctuary for the oppressed American male—a place where men of like mind can gather in dusty, dimly lit aisles and fondle power tools. Yet there is finite demand even for the best ideas. Increasingly, new Home Depot stores are cannibalising existing-store sales. Competitors, such as Lowe's, a chain that is more female-friendly, are profiting at Home Depot's expense, a sure sign of a firm, or a market, that has peaked. After two decades of blistering growth, the spread of Home Depot's day-glo orange signs across suburban strip malls may soon start to slow.

That, at least, is the view of Home Depot's shareholders, who have in the past year lopped more than $60 billion (over 60%) off the firm's market capitalisation. Yet Bob Nardelli, Home Depot's star boss, who was hired from General Electric (GE) in December 2000, does not agree. Sales at existing stores have declined, according to Mr Nardelli, because consumer spending has weakened and because Home Depot is upgrading stores and merchandise to cater to, you guessed it, female shoppers. Some analysts hope for a change in strategy when they next meet Mr Nardelli, on January 17th. But so far he has claimed to see no reason to change plans: 200 new stores opened in 2002, 200 are due to open in 2003, on top of the existing 1,500.

Yet Mr Nardelli's explanations look increasingly dubious. Colin McGranahan of Sanford Bernstein, a research firm, has analysed the 214 stores that Home Depot opened between May 2001 and October 2002. Of these, 100 were in markets (defined by a ten-mile trading radius) that already included at least one existing Home Depot store. Some had several. Between them, Home Depot and Lowe's operate nearly 2,200 outlets. Mr McGranahan's work suggests that the market will reach full saturation, at a rather precise 2,568 stores, early next year.

With both Lowe's and Home Depot rushing to fill any remaining spots, there may be a perverse incentive for both firms to overbuild. But shareholders also worry about perverse incentives in the boardroom. Mr Nardelli was hired at the peak of the golden era of American management. As befits a man who negotiated a pay package that guarantees him a minimum of $6.5m a year (and the potential to earn many tens of millions more), Mr Nardelli promised many wondrous things. By centralising management, squeezing labour costs and chasing new markets, Mr Nardelli said that he would double sales and more than double profits by 2005.

Having put their names to this absurdly generous contract, it is hard to see how shareholders could have avoided the sense of disappointment that has followed. Mr Nardelli, a manufacturer with no retailing background, has made mistakes, they grumble. For instance, he cut full-time staff, capped wages and recruited a cadre of former military officers to run his stores. Staff morale and customer service duly collapsed.

Dennis Donovan, another ex-GE man brought in by Mr Nardelli to run his human-resources department, had to make an embarrassing U-turn and is hiring more full-timers again. (Mr Donovan may be the world's highest-paid personnel boss, receiving a staggering $21m in 2001, almost as much as Mr Nardelli's $24m.) Home Depot's formerly decentralised, free-wheeling management style may have lacked efficiency, but Mr Nardelli dismantled it before first investing in the computers he needed to run a centralised operation, complain shareholders.

The biggest worry is that, in a last-ditch gamble to justify his pay and past promises, Mr Nardelli may take some really stupid gambles. His contract could reward him more generously if he wrecks the company and is fired than if he settles for slow or no growth. With market saturation approaching, his share options are probably worthless—unless they are repriced much lower. On the other hand, Mr Nardelli would collect a $20m lump sum and tens of millions more in accelerated salary, bonuses, forgiven loans and other goodies if he were fired “without cause”. What is “cause”? Home Depot avoids paying up only if Mr Nardelli is found guilty of “willful gross neglect or willful gross misconduct”, or is convicted for a “felony involving theft or moral turpitude”. So long as he does not rob his firm outright, Mr Nardelli has little to lose, it seems.

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America's steel industry

A miracle at Bethlehem

Jan 9th 2003 | NEW YORK
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America's steelmakers dare to hope again

AP

No more kicking the management

NOT content with buying two rusting steel companies, Wilbur Ross, America's straight-talking “king of bankruptcy”, now wants a third. On January 6th, International Steel Group (ISG), Mr Ross's acquisitive new steel company, made an offer for Bethlehem Steel, a big, bankrupt steelmaker. Together with steelmaking assets from LTV, another big, bust steel firm and Acme Steel, a smaller firm whose assets Mr Ross bought in September, the combined firm would have the capacity to mill 16m tonnes of steel a year, making it the biggest steelmaker in America. On January 9th, another giant, US Steel, said it would buy National Steel for $750m.

Mr Ross, who got a bargain when he bought LTV's assets for $325m last February, is the first to admit that the $1.5 billion he is offering for Bethlehem Steel, an old-fashioned “integrated” firm that makes steel from iron ore, not scrap metal, is a “very full price”. In part, this is because steel prices have risen: in the past 12 months, the price of a tonne of hot-rolled steel has shot up by more than 50%. But Mr Ross's uncharacteristic generosity also reflects what Robert Miller, Bethlehem's chief executive, says is “the most dramatic thing that has happened in the US steel industry in the last 20 years”—an extraordinary new labour contract with the United Steel Workers of America (USWA), the industry's hitherto muscular labour union.

Mr Ross will not divulge the full details of the agreement that ISG struck with the union last month. But the contract, whose features Mr Ross now hopes to replicate at Bethlehem Steel, contains several unexpected reforms. One is a new flexibility towards union “work rules”. The old LTV operated with more than 30 different job classifications, keeping highly paid steelworkers in jobs such as mowing lawns or cleaning toilets. The new contract has whittled the list down to six, and allows ISG to outsource more menial work. Fabulously generous pensions and health-care benefits—blamed for many recent steel bankruptcies—have also been reduced. Steelworkers at ISG must now endure the same sorts of benefits that most white-collar Americans put up with: “co-payments” for doctor visits and pensions whose pay-outs are no longer guaranteed.

In return, Mr Ross's steelworkers get a slice of ISG's profits and bonuses tied to any productivity improvements they can squeeze out of the manufacturing process. “You'd be amazed at how much the fellow who has sat for 15 years in front of the machine knows about it,” says Mr Ross. There have not been many complaints so far: after just eight months in operation, ISG's workers collected bonuses worth seven weeks' pay at the end of last year.

Credit must go in part to Mr Ross, who has played a canny hand. Although he made deep cuts among LTV's blue-collar workers, Mr Ross was far more savage with the firm's bloated corporate management. Just 15% of LTV's former white-collar staff were kept on by ISG—“a huge statement to the union”, according to one source close to Bethlehem Steel. Mr Ross has also been careful to toe the union line on the evils of foreign competition: all he seeks, he says, is a “level playing-field”, devoid of foreign government subsidies. It seems that Leo Gerard, the USWA's pugnacious leader, has found a steel boss he can deal with.

To some extent, Mr Gerard has had no choice: 35 steel firms have gone bust since 1977. Of these, 17

have liquidated themselves, costing USWA members health-care benefits. But Mr Gerard also deserves some praise for his role. Having lobbied furiously for trade tariffs on imported steel, which President Bush duly delivered last March—almost triggering a trade war with the European Union—the USWA has largely kept to its side of the bargain, throwing its weight behind industry consolidation. Mr Bush's widely criticised imposition of tariffs so that steelmakers could restructure themselves might yet turn out to have a positive side.

The upshot? ISG now claims to be the lowest-cost producer of steel in America— cheaper even than modern, non-unionised “mini-mill” operators such as Nucor, which make steel out of scrap. Bethlehem will not be quite as profitable for Mr Ross as his LTV deal has been. But one year ago, it would have been hard to find a buyer willing to pay anything at all for the company's ageing blast furnaces. Most startling of all is the possibility of an American steel industry emerging that is strong enough to survive without trade barriers or government handouts. That really would be something of a miracle.

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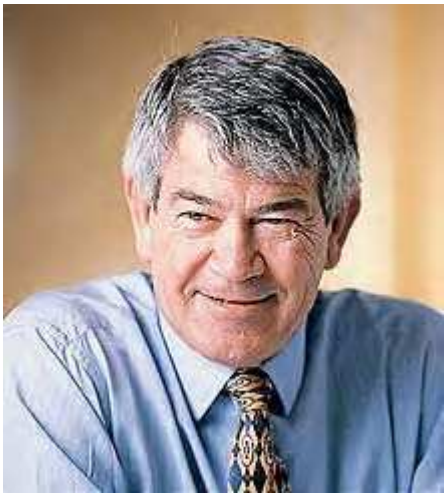
Mining

Dirty diggers

Jan 9th 2003 | JOHANNESBURG
From The Economist print edition

A South African boss goes down under


The ego has departed

AUSTRALIANS and South Africans love to scrap. South Africa's cricket team was officially named the world's best this week, to great fury in Australia whose team had just suffered an embarrassing loss to England. Rugby matches, surfing competitions and the world barbecue (or *braai*) championships are always hot-headed affairs. South African newspapers keenly plot the Ozzie dollar against the rand. Each January statisticians grimly compare Christmas road-death rates in the two countries.

But nothing gets southern-hemisphere blood boiling more than gold, diamonds and other minerals. A year ago, South Africa's AngloGold fought and lost a long battle to control Normandy, an Australian gold-mining company. In July, Brian Gilbertson, a cocky former rocket scientist, and a South African, took the helm at BHP Billiton, a multinational mining firm based in Australia. On January 6th, after six uncomfortable months and to the delight of many Australians, Mr Gilbertson abruptly quit—reportedly with a multi-million-dollar pay-off. He promptly escaped the media pack by heading off for a relaxing trek in the jungle.

The brash self-promoter may well have been pushed from his post. In the staid world of Australian business, the upstart who once reputedly demanded that his company's jet be emblazoned with his initials, BPG, ruffled feathers. Legend has it that when he was at Gencor, a Johannesburg-based mining company, browbeaten staff would greet his arrival by helicopter by declaring that “the ego has landed”. At Billiton, a firm created by Gencor as a vehicle for international expansion which he ran from 1997, he first oversaw what was viewed as a daring expansion into aluminium smelting. He blazed a trail for other South African companies by listing on the London Stock Exchange, also in 1997. He then helped to engineer the merger, worth nearly $40 billion, with Australia's BHP in May 2001, creating the world's largest mining company. But his goal still remained further dramatic expansion and, of late, he had been casting a keen eye over various Australian oil firms.

The more timid and Australian-dominated board of BHP Billiton wanted none of that, calling instead for management time to be spent bedding down the merger and cost-cutting. According to the company, Mr Gilbertson left because of “irreconcilable differences” with the board. The first task of the conservative new boss, Chip Goodyear, who is an American, is to make savings of $500m.

Might BHP Billiton rue the departure of the swashbuckling Mr Gilbertson? The firm's share-price fell by 4% when the news of his departure broke this week. Mr Goodyear's safety-first approach will probably reassure investors before too long—but what of his vision? Mergers and consolidation have resulted in a few big global companies, including BHP Billiton and Anglo-American, dominating the worldwide digging business. Prices for commodities such as platinum and gold are rising, which might be expected to encourage bold strategies, such as expanding into oil. But BHP grew fast in the early 1990s, piling up a heap of expensive debt and bad memories. As for Mr Gilbertson, speculation is rife that the returning hero will soon find a job from which to pursue his expansionist aims—back in South Africa.

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Television in Indonesia

Screen test

Jan 9th 2003 | JAKARTA
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Will Indonesia's government wreck a rare thriving part of its economy?

ONE of the few things to go right in Indonesia in recent years was media reform. Soon after the ouster in 1998 of President Suharto, the country's strongman of 30 years, the new government abolished the reviled Ministry of Information, freed anybody to set up a newspaper or magazine and added four more nationwide television broadcasting licences to the existing seven. About a dozen local TV stations sprang up, and the number of radio stations doubled. The world's fourth-largest population, fascinated by the sudden free flow of information, read, watched and listened in droves, fuelling a media boom when most of the economy was bust.

The boom may now be ending. In late November, parliament passed a new broadcasting law to increase regional programming and diversify ownership beyond Jakarta's business elite. In so doing, it revoked the national licences on which broadcasters had built their business, hurting both banks that had lent to them and investors who bought their shares, and further denting Indonesia's image as a place to do business.

Almost all of the national broadcasters are Jakarta firms with close connections to friends or family of Mr Suharto. The new law attempts to break their influence by restricting licences to a single province (Indonesia has 26), and forbidding cross-ownership of newspapers, and radio and TV stations. (A local body in each province will also set guidelines about content, so that the hedonists of Bali could permit racier shows than the relative zealots of Aceh.) The share prices of listed broadcasters with costly but now redundant nationwide networks, such as Indosiar and Surya Citra Media, have plunged.

Perhaps foreign firms will venture into the breach. The new law will allow them to invest in Indonesian media companies for the first time. But their stake will be limited to 10%, and given Indonesia's instability and corruption, that will probably not be enough to tempt them.

More likely, the existing broadcasters will wriggle off the hook. They are threatening to challenge the law in the Supreme Court. Influential companies may be able to persuade Indonesia's pliable courts to ignore the law altogether.

If anything, the new law might actually reduce regional programming, as media firms are likely to invest only in expensive infrastructure in the wealthy, more populous provinces. Indeed, the only firms rich enough to make such investments are the very ones that the law seeks to restrain. Indonesia's bank restructuring agency is grappling with a similar problem: it has taken over ill-gotten assets from some of Mr Suharto's cronies only to find that nobody except the original owners wants to buy them. In a country where the capitalists were all cronies, business and politics are not so easy to disentangle.

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Outsourcing

America's pain, India's gain

Jan 9th 2003 | CHENNAI
From The Economist print edition

At least one corner of the IT world is booming again

SURGING revenues, strong profit growth, lucrative new contracts and a massive recruitment drive—can this really be the information technology (IT) industry in 2003? Yes, provided you are in India, where software firms are flourishing thanks to booming outsourcing business from some of the world's leading multinationals. Though the Indian outsourcing industry was heavily hyped a couple of years ago, its current strength reflects something of a recovery after a tough time at the start of the decade, when the bursting of the tech bubble and a slowdown in America led many big firms to freeze all technology spending, even when, as with outsourcing, it could cut costs.

Now that those firms are over their initial panic and focused on cost reduction, the appeal of outsourcing has soared, especially to low-cost offshore locations such as India. As a result, the export revenues of India's software services market reached $6.2 billion last year, up from under $500m in the mid-1990s.

The Indian outsourcing business grew out of a more basic industry providing Indian computer programming and code-writing expertise to American hardware and software giants. When Indian firms entered the outsourcing business serving firms of all sorts, a business then dominated by the likes of IBM and EDS, much lower labour costs held the key to its rapid revenue growth: over 50% a year in 1994-2001. The time difference also gave India a selling-point. Thanks to, say, the ten-hour time gap between America and India, American clients could offer 24-hour service by switching to Indian workers during the American night.

In 2001, as the dotcom, wireless and optical-networking businesses started to collapse in America and Europe, and IT spending slowed dramatically, Indian outsourcing revenues fell far below expectations, rising by only 20% in 2001, compared with initial expectations of 40%. This hit profits hard, as it coincided with an investment and recruitment boom designed to tap the expected rapid growth.

Having misread the economic tea-leaves, the industry reacted with un-Indian decisiveness, bent on turning adversity into opportunity. For almost a year from mid-2001, they put a freeze on investments in software development centres and on recruitment. Instead, an aggressive marketing campaign was launched to boost the image of India as an outsourcing location the equal of anything on offer from such leading global outsourcing vendors as IBM, EDS and Computer Sciences—and far cheaper.

As big multinationals resumed their efforts to cut costs, Indian firms were thus well-placed to take advantage of the renewed outsourcing opportunity. Over the past year or so, much bigger contracts than before have been won by the five firms that are emerging as the dominant forces in Indian outsourcing: Tata Consultancy Services (part of the Tata family group), Infosys Technologies, Wipro Technologies (the global software services arm of the diversified Wipro), Satyam Computer Services and HCL Technologies.

Between them, these firms had a 40% share of India's outsourcing business last year. Tata's revenues should top $1 billion this year, with Infosys and Wipro not far behind. In the past year, Tata has won at least three outsourcing contracts each worth over $50m—from GE Medical Systems, Verizon and United Utilities. Infosys and Wipro now also have several clients with contracts worth at least $30-40m each. All are now busily hiring again.

This progress is increasingly at the expense of IBM et al, which have seen outsourcing revenue growth slow in the past year. These firms already have some operations in India, but are likely to ramp them up fast to reduce the cost advantage enjoyed by their Indian-based rivals. Indeed, buying a leading Indian outsourcer may be an option. A few months ago, EDS was said to be considering Satyam, the fourth-largest domestic firm, as a possible acquisition. Satyam said it was not for sale.

Though demand for outsourcing seems certain to grow fast in the next few years, the Indian firms seem certain to face fiercer competition to win the new business. Already, they are trying to reposition themselves higher up the software value-chain. They are offering several new services, most notably IT consulting, not least because outsourcing deals in these areas are typically much larger and generate higher profit margins than the traditional bread-and-butter offering of software development and maintenance.

Passage from India

Just as the established global outsourcing firms are increasing their presence in India, so the leading local firms are becoming more multinational. In part, this is because customers need to be reassured that outsourced services would not be disrupted by, say, a nasty further deterioration in political relations between India and Pakistan. Less speculatively, they have been trying to meet client demands for global outsourcing for 24 hours a day by opening operations across America, Europe and the Asia-Pacific region.

At some point, the Indian firms may find themselves facing a choice similar to that now confronting IBM, EDS and others: move to a lower-cost location or become uncompetitive. Some day, China, Russia or the Philippines are likely to emerge as a seriously competitive threat to Indian outsourcing. The current thinking in India is that it has a window of three to five years before those countries match its value for money in outsourcing.

The leading Indian outsourcers reckon that the key to their long-term prosperity is bagging ever larger deals and moving ever higher up the value chain. To this end, they reckon the cultivation of strong personal connections with client firms at board level will be crucial. That, as much as chewing over the latest geopolitical hot potatoes, may be what has inspired Narayana Murthy, chairman and chief mentor of Infosys, and Nandan Nilekani, the firm's chief executive, to head off to the snowy slopes of Davos in the fourth week of January to mingle with the global corporate elite at the World Economic Forum. Alas, they may find that not many bosses of potential client firms, especially IT companies from America and Europe, will feel able to attend such a high-profile boondoggle, with their business as bad as it is. India's IT stars are exceptional indeed.

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Face value

The boss as Superman

Jan 9th 2003
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AP

Is it a bird? Is it a plane? No, it's Roberto Colaninno, trying to save Fiat

Get article background

IT IS a gripping scene. A big company is in trouble, its owners and creditors squabbling as it rushes headlong towards a nasty end: at best being broken up with the good bits falling into foreign hands, at worst bankruptcy. Then—presto!—out of the blue flies in a saviour, an experienced boss armed with cash and a plan to take charge and put things right. Who could resist our business Superman? But does he really exist?

It seems he does, and is living in Italy, having replaced his Clark Kent alias with that of Roberto Colaninno. He ran Olivetti and then Telecom Italia, from which he was cruelly ousted when Pirelli took control in 2001. Having watched the collapse of the Fiat industrial empire with growing dismay, he has now sprung into action. He says it is vital for Italy, and especially the Turin region, to retain a car industry. Many thousands of jobs are at stake. Fearlessly, Mr Colaninno has now donned his red underpants, laid his reputation on the line and offered to run Fiat.

He is now finalising a rescue plan that will probably be presented to Fiat's board in the next couple of weeks. If he wins their support, all—all?—he has to do is persuade the banks and the Agnelli family, which together control Fiat, to stand aside and let him work his magic. According to this script, Fiat can be saved not just as an Italian concern, but also as a force in the global car market, in which it is now failing. Fiat's shares rose by one-fifth on news of Mr Colaninno's possible coming.

It sounds good. Too good, perhaps. Mr Colaninno is no slouch, but at every turn he faces almost impossible odds. There are plenty of examples, especially in America, of people who think they can turn around a company getting the chance to do so by buying it. But it is rare for an outsider to win that opportunity merely by proposing himself to those who now control the firm, offering only the purchase of a minority stake plus, of course, the brilliance of his ideas and management skills.

Mr Colaninno is no slouch, but at every turn he faces almost impossible odds

In the case of Fiat, Mr Colaninno needs to win the support of multiple constituencies, including the government. Last summer, when he first began privately to express interest in Fiat, he was quickly blocked by Silvio Berlusconi, Italy's prime minister as well as one of its most powerful businessmen. Mr Berlusconi changed his mind only recently, when it became clear that his own efforts to find a solution were failing. Now he hopes to ride on Mr Colaninno's coat-tails and take credit if things go right.

Three huge obstacles remain: the banks, the Agnellis and the business itself. Four big Italian banks ultimately control Fiat's fate. If Fiat meets debt-reduction targets and stems the outflow of cash from its car business, the banks will continue to support it, including with new loans in 2005. If Fiat slips, it will in effect be bust. Its debt was recently downgraded to junk status by Moody's, a rating agency, which gave warning of worse to come.

The banks met on January 8th to hear a progress report and to consider a new plan to split Fiat Auto from the rest of Fiat, thereby limiting the negative impact of cars on the group as a whole. This would need—and probably fail to win—the support of General Motors (GM), which owns 20% of Fiat Auto and may, under a put-option deal, have to buy the rest of it as soon as next year. GM is now working with Fiat to improve a rescue plan for Fiat Auto agreed last autumn. It wants to renegotiate the option—or, better still, to scrap it.

The bankers are in two minds, not least because this new plan may not be all that different from what Mr Colaninno is proposing. And although they still have good reason not to trust the Agnellis, they also have good reason to be cautious about Mr Colaninno. Some have worked with him before and respect his abilities. Others are openly sceptical.

Truth, justice and the Italian way of life

The Agnellis, too, seem divided—with the protracted illness of the clan chief, Gianni, not helping. Late last year the family, which uses its 34% stake to control Fiat, broadly rallied around Umberto Agnelli's efforts to save the group. Umberto backed an attempted coup to install new managers friendly with Mediobanca, a Milanese investment bank. But other banks saw this as a direct attack and rallied in turn around Paolo Fresco, Fiat's chairman. A new chief executive was imposed beneath him, but Mr Fresco narrowly survived—though he is still due to retire in July. He has since been receptive to Mr Colaninno and has given him the go-ahead to talk to Fiat's board.

The failed coup discredited Umberto within the family. Susanna Agnelli, his sister, has become an influential voice favourable to Mr Colaninno. But the split means that Mr Colaninno has an even harder job to persuade the family to back his plan. He does not yet know if the family would be prepared to cede control in return for his investment—of maybe *euro*2 billion ($2.1 billion)—and managerial efforts to save the group. Nor does he know if the Agnellis are privately attempting to undermine his efforts to win the banks' support.

What if Mr Colaninno somehow persuades both the banks and the Agnellis to give him a chance? His final obstacle may be the biggest of all. Poor management has seen Fiat's car business decline to the verge of collapse. Its product range is weak, its market share is evaporating and it is haemorrhaging cash.

What could Mr Colaninno do that nobody else can? He claims that his long experience in the components sector gives him a special insight into how to fix the car business. He would hire better managers and address weaknesses in design. He has not said so, but he might be far tougher than existing management about shutting inefficient car factories, especially if he can convince politicians—above all, Mr Berlusconi—that the alternative will be more dramatic job losses due to the bankruptcy of the entire group. Even so, the enterprise is hugely risky. A task fit for Superman? Or merely an impossible one?

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Correction: Rolls Royce

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In last week's story about luxury cars, we said that the new Rolls-Royce was selling for $250,000. In fact, its price starts at £250,000 ($400,000). Still worth every penny, no doubt.

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Corporate boards

The way we govern now

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Unchanged for too long, boardrooms are at last being shaken up

IN ANTHONY TROLLOPE'S novel of 1875, “The Way We Live Now”, the board of the fraudster Augustus Melmotte's Great South Central Pacific and Mexican Railway Company would never sit for more than half an hour. “Melmotte himself would speak a few slow words...always indicative of triumph, and then everybody would agree to everything, somebody would sign something, and the board...would be over.” The cases of Enron, WorldCom, Marconi and other recent debacles suggest that boardroom life is still all too often as it was in Victorian England. Too many boards are stuffed with yes men who question little that their chief executives suggest.

Thanks to a spate of recent proposals, however, the boardroom is beginning a transformation. Many countries are scrambling to review the way that companies are governed, and everywhere the main focus is the boardroom. Only this week, a commission set up by the Conference Board, a business lobby group in the United States co-chaired by John Snow, President Bush's nominee for treasury secretary, issued its recommendations on the role of the chief executive and on shareholder and auditing practices.

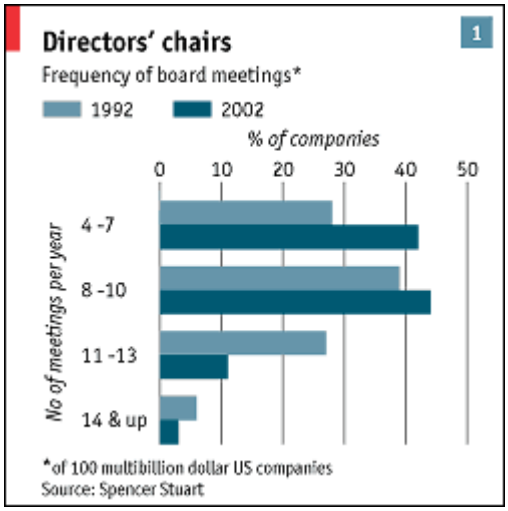
In Germany, a committee under Gerhard Cromme, head of the supervisory board of ThyssenKrupp, produced the country's first corporate-governance code a year ago. In Canada, the Council of Chief Executives, a body of 150 industry bigwigs, recently proposed new guidelines for listed companies. France, too, has launched a review of best corporate-governance practice. And in Britain, Derek Higgs, a leading City figure, is about to report to the government on the role of non-executive directors. By imposing new duties and constraints on directors, policymakers are hoping to avert future corporate scandals.

Bossing the boss

The greatest changes in governance are under way in America. The two key sets of reforms are those in last summer's Sarbanes-Oxley act, now being turned into rules by the Securities and Exchange Commission (SEC), and those proposed by the New York Stock Exchange (NYSE), which are also being scrutinised by the SEC (see article). Both will have influence far beyond America's borders, if only because companies that want to tap the world's largest capital markets will have a strong interest in complying with the rules, even if (as at the moment seems likely) they are not compelled to do so.

The structure of boards in the United States has typically given

chief executives immense power. In three out of four companies in the Standard & Poor's 500, the roles of chairman and chief executive are combined. To split the jobs has generally been seen either as a transitional arrangement or a sign of weakness. Even where it seems to work well, it rarely works for long. Only last month, William Stavropoulos, the chairman of Dow Chemical, grabbed back the job of chief executive from Michael Parker, who had been in the post for the previous two years.



Not only do bosses generally combine the two top jobs; many face a board on which a significant number of directors have commercial links with the company. A survey in 2002 by the Investor Responsibility Research Centre (IRRC) found that 13% of companies listed on the NYSE did not even have a majority of independent directors. Moreover, according to The Corporate Library, a lobby group for good governance, directors of many companies, such as Verizon, Pfizer, Citigroup and Bank of America, have interlocking relationships: the chief executive of company A sits on company B's board and vice versa. The Corporate Library has created a database to expose such incestuous networks.

Chief executives have tended to dominate the choice not just of board members (where search committees are usually encouraged to look for “consensual” candidates who will not rock the boat) but of their successors too. The IRRC finds that about 20% of companies on the NYSE do not even have a board-level nominating committee, independent or otherwise.

In general, board committees offer little occasion for scrutiny. A survey by the *New York Times* found that, in 420 of a selection of 2,000 large American public corporations, the board's compensation committee, which determines the boss's pay, includes relatives or people with ties either to the boss or to the company.

Even more alarming is the case of audit committees, a key tool of external financial oversight. Martin Taylor, a British businessman who sits on five boards in five different countries, recalls one American audit committee that used to meet after the figures that it was supposed to scrutinise had already been released.

To European eyes, America's intense concentration of power at the top looks odd. In Germany, for instance, companies are obliged by law to have a two-tier board: a management board takes responsibility for the day-to-day running of the company and a supervisory board, comprising representatives of shareholders and workers, has strategic oversight. Members of the management board are jointly responsible for running the company.

Power is thus (theoretically, at least) highly diffused. An intrusive chairman of a supervisory board can cramp the style of managers. But things don't necessarily work that way. An excessively powerful chairman of the management board is in effect a chief executive, who may keep the supervisory board in the dark and wield huge power through a kitchen cabinet of managers. Sir Adrian Cadbury, Britain's leading champion of corporate governance, points out in a new book* that the Chrysler board learned of the impending merger with Daimler Benz at the start of February 1998 and discussed negotiations throughout; Jürgen Schrempp, the boss of Daimler Benz at the time, told his management board only at the beginning of April, and his supervisory board in early May, the day before the merger was announced.

Britain too tries to curtail the power of the chief executive. He or she reports to the board, which usually has a non-executive chairman. Indeed, whereas Americans look askance on boards that split the roles, Britain's chief financial regulator, the Financial Services Authority, looks askance on boards that don't.

Fat fees 2

Based on a survey of boards of Fortune 1000 companies, 2001

Size of company (by sales)	Average number of directors	of which outside directors	Average annual retainer, $
Under $3bn	9	7	33,792
$3bn-$4.999bn	10	8	37,567
$5bn-$9.999bn	12	10	42,264
$10bn-$19.999bn	12	10	47,589
$20bn and over	13	11	56,587

Source: Korn/Ferry International

Who sets the agenda?

In removing some of the unchallenged authority of the chief executive, America's proposed reforms will place new demands on company directors. They will, for example, have a new obligation to meet in what the NYSE calls “executive session”—an odd phrase, given that executives will not be present. This proposal, now widely discussed in the United States and recommended this week by the Conference Board's commission, may turn out to be one of the most potent of all governance reforms. It certainly alarms many chief executives.

Few large companies have held such meetings in the past—not surprisingly. After all, they will give directors a chance to reflect on whether the chief executive has really answered all their questions; whether he is involving them in the development of strategy; and whether the agenda he sets covers the right points. That may be the main battleground. For setting the agenda and steering the flow of information determines corporate control. Moreover, if the presiding director is usually the same person, he or she may come to acquire some of the authority of an independent chairman of the corporate board, communicating with the chief executive on behalf of the other directors. That would be highly significant.

A surprisingly large number of voices now favour switching to the British model of a separate chairman: 69% of directors of large American companies told a recent poll by McKinsey, a management consultancy, that they backed the idea. But for the moment, it is unlikely to happen. “It's very hard to recruit a chief executive unless the chairman's title comes too,” says Dennis Carey of Spencer Stuart, an executive-search firm.

Recruiting directors is also tough at the moment, largely because of the perceived increase in both responsibilities and risk. Headhunters such as Peter Crist of Korn/Ferry report a stampede to find chief finance officers to meet the NYSE proposal that audit committees be chaired by a person with accounting or similar expertise in financial management.

The hunt is that much harder because big companies are now reluctant to allow their senior managers to sit on more than one other corporate board. A quick glance down the list of bosses of America's top 100 firms shows that almost all sit on at least one and sometimes two other large companies' boards. But the time demands of board membership have grown, especially if a director sits on the increasingly burdened audit committee. Over the past decade, reckons Tom Neff, one of America's most experienced board recruiters, the demands on the time of a director of a large company have increased by about 25%. Meetings are now often longer than the typical two to four hours, and held perhaps eight or nine times a year.

But the big increases are in the time taken by the various board committees and by telephonic meetings between formal boards. The audit committee, which once met for two hours, now often runs for up to six. And this excludes travel time and the one to two days of research and thinking that the National Association of Corporate Directors recommends to prepare for each board meeting.

Over and above the constraints of time, there has been a rise in the perceived risk of sitting on a corporate board. In Britain, 15 former directors of Equitable Life, an insurance company that ran into trouble, are currently being sued for more than £3 billion ($4.8 billion)—and their insurers claim that their liability cover does not apply. In the United States, claims against directors have been rising both in number and in size. And insurance cover is becoming both narrower and more expensive. Not surprisingly, the average size of the board of a large American company has fallen from 15 to 11 over the past ten years.

Behave yourself...

Board members may be harder to recruit, but once they sit around the mahogany table, their behaviour will be scrutinised increasingly closely. A survey conducted by Korn/Ferry in 2001 found that 42% of board directors regularly assessed board performance and 67% regularly evaluated the chief executive. But that does not impress Jeffrey Sonnenfeld, a guru from Yale School of Management. “I can't think of a single work group whose performance gets assessed less rigorously than corporate boards,” he complained in the *Harvard Business Review* last September.

Human-resources consultancies are eager to rectify this. Mercer Delta, for example, has devised an elaborate set of measures to classify five different types of board behaviour, from the passive (essentially, the South Central Pacific and Mexican Railway Company approach) to the operating, where the directors have, in effect, stepped in to take control. The consultancy's head of corporate governance in Britain, Sean O'Hare, reports a certain queasiness about individual peer assessment: board members dislike having to say honestly what they think of each other's abilities and foibles.

But what exactly should they be assessing? The doughty Nell Minow of The Corporate Library is fond of quoting this eloquent summary of a board's responsibility: “What a CEO really expects from a board is good advice and counsel, both of which will make the company stronger and more successful; support for those investments and decisions that serve the interests of the company and its stakeholders; and warnings in those cases in which investments and decisions are not beneficial to the company and its stakeholders.” The author? Kenneth Lay, chief executive of Enron, speaking at the (wait for it) Centre for Business Ethics at the University of St Thomas in Houston in April 1999.

Chief executives tend to value team players on boards. Corporate-governance gurus look for challenge and dissent. Mr Sonnenfeld's article reported that the best-performing companies have “extremely contentious boards that regard dissent as an obligation and that treat no subject as undiscussable”. But contention and dissent do not necessarily foster the climate of trust and constructive dialogue that is also essential in an effective board.

Does a board work better if it includes executives other than the boss and the chief finance officer? Americans generally think not: the proportion of executives around board tables has tended to decline. In Britain, on the other hand, three or four senior executives other than the boss expect to be board members, and some British corporate-governance experts argue that this is beneficial. “The way the chief executive reports to the board is different because the executive directors are there,” argues Sir Adrian Cadbury.

Behind many of these changes is an awkward question. Should non-executive directors see themselves primarily as the owners' watchdogs? The law everywhere is ambiguous and unsatisfactory on this point. Colin Mayer, a professor of management at Oxford University, argues that non-executives have not been good at disciplining under-performing managers. But he also believes that non-executives have a special duty to communicate information to investors, and should be viewed as their “internal agents”. The trouble is that, except in a crisis, institutional investors generally want to see the person who is gripping the helm, not the non-executives.

Besides, as Rakesh Khurana of Harvard Business School points out, the interests of investors are not all identical. Big pension funds may take a long-term view because they are too large to trade actively in the shares they hold. But active fund managers move in and out of a position several times a year or a quarter. Directors may find it harder to respond directly to them.

...because it pays

For years, investors have had a good reason to ignore good governance. Academic research found no clear causal link with financial performance. New research, however, threatens to change that. Paul Gompers of Harvard Business School and two colleagues looked at 1,500 firms in the 1990s and found those that were most responsive to shareholders would have enjoyed returns 8.5% a year higher than those run as management dictatorships**.

When regulators seek to impose good governance, they may do more harm than they prevent. Some folk, such as William Allen, a respected former judge on the Delaware Chancery Court, where most big

corporate lawsuits are heard, who is now a law professor at New York University, already fret that the current changes go too far, staunching the appetite for risk and innovation. Many of the proposed new requirements insist on measures that most boards ought to have met, one way or another, of their own volition.

Will the new rules improve governance? They will make good governance easier, but only if both boards and investors are determined that they should do so. Ultimately, the best way to prevent the occasional Melmotte from bamboozling directors is to have directors who are willing to stake their reputations on their job. And no rules can guarantee that.

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* “Corporate Governance and Chairmanship: a Personal View”, by Adrian Cadbury. Oxford University Press, 2002

** “Corporate Governance and Equity Prices”, by Paul Gompers, Joy Ishii and Andrew Metrick, forthcoming in the *Quarterly Journal of Economics*

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Governance in America

Shifting power

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New rules to redefine the corporate director

A “TECTONIC shift of power” is how Martin Lipton, a lawyer who has long advocated changes in corporate governance, describes the two sets of reform proposals currently under review by the Securities and Exchange Commission (SEC). One set, under the Sarbanes-Oxley act, includes the following:

Accounting regulation—the creation of a public accounting-oversight board to oversee the auditing of public companies, and restrictions on the consulting services that auditors can offer clients.

Audit committees. The company must name “financial experts” on the audit committee and say whether they are independent.

Executive responsibility. Chief executives and finance directors must sign off a company's annual and quarterly reports; and they must hand back bonuses if fraud results in an overstatement of earnings.

The second set, from the NYSE, adds further obligations. It calls for:

• Listed companies to have a majority of independent directors, without previous close links with the company.

• Regular meetings of non-executive directors in sessions at which the company's management is not present. The presiding director's name must be made public.

• The compensation and nominating committees, as well as the audit committee, to be composed entirely of independent directors. The audit committee must be chaired by someone with accounting or similar financial expertise.

• The publication of corporate-governance guidelines, setting out (among other things) provision for annual evaluation of the board and the boss.

A further rule, proposed by Harvey Pitt when he was chairman of the SEC, may matter most of all, if it survives: it would force investment advisers to disclose how they cast proxy votes.

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The Bank of Japan

Divining inspiration

Jan 9th 2003 | TOKYO
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Can a new central-bank governor drag Japan out of its economic rut?

Get article background

WITH prices still falling and the economy on the brink of its fourth downturn in a decade, it is hard to summon up much optimism about Japan. Yet change creates opportunities, if nothing else, and a new boss is about to take over a crucial institution: the Bank of Japan. On March 19th Masaru Hayami's five-year term as the central bank's governor will end. In the next few weeks Junichiro Koizumi, the prime minister, is expected to name his replacement, along with two new deputy governors.

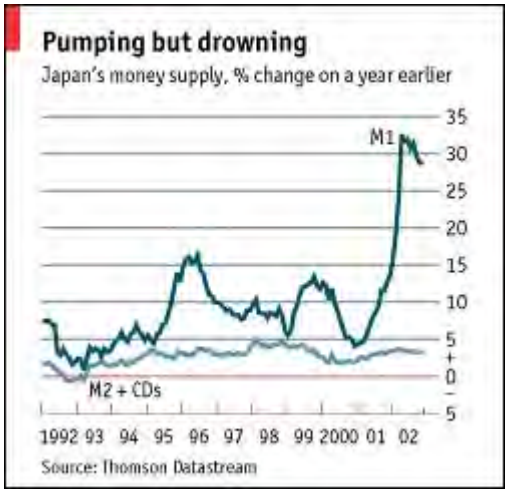
Mr Koizumi has said that he will pick somebody “who will actively work to end deflation”, a task that many accuse the central bank of having taken far too lightly. Weary optimists are hoping that the prime minister means what he says and will appoint a determined deflation-fighter, that Japan's parliament will approve his choice, and that in 2003 Japan will finally start to climb out of its downward spiral.

Naturally this is easier said than done. Sceptics, including many within the Bank of Japan, argue that Japan's problems are structural, so that the bank can do little to combat deflation. They point out that, however lax it may have been in the years after the bubble burst, the Bank of Japan has been furiously pumping money into the economy for nearly two years now. With interest rates already at zero, it has done this through what it calls “quantitative easing”. It has boosted the balances that banks hold at the central bank to nearly ¥20 trillion ($167 billion) and is buying ¥1.2 trillion a month of government bonds, more than 40% of new issues.

These actions have boosted the amount of “base money”—currency plus demand deposits—sloshing around the system by 37% since March 2001 (see chart). Yet this has not translated into faster growth in broader forms of liquidity—such as time deposits and certificates of deposit—that reflect credit creation and higher demand. Companies, already deeply indebted, are reluctant to borrow when prices are falling. Banks, already laden with bad loans, are in no hurry to lend. The only way to change this, say many in the central bank, is to write off bad loans and pursue structural reforms.

The Bank of Japan's detractors argue that the central bank should

be doing more. It could pump in still more liquidity, for example by buying an even bigger share of new government-bond issues and then gobbling up part of the much bigger pile of bonds already in circulation: private investors hold roughly ¥300 trillion-worth. Moreover, say the central bank's critics, it could boost import prices, thus raising overall prices, by purchasing foreign bonds, in a determined effort to drive down the yen.



Robert Feldman, chief economist at Morgan Stanley in Tokyo, sums up the impasse as a debate over "whether the arteries are clogged, or the heart just isn't pumping hard enough." Mr Koizumi says that he wants to end the stalemate, by combining bolder monetary policy to get the heart pumping with structural reforms to unclog the arteries. He promised just such a combined effort in a speech this week, saying that his government will work "jointly with the Bank of Japan in order to rein in deflation by all policy means available." But whereas his proposed structural reforms are a continuing battle, the appointment of a new governor will probably be a one-off chance to overhaul monetary policy. He will face several obstacles if he chooses to take it.

The first is finding candidates, for both the top job and the two deputies' seats, even though a bewildering array of names is being bandied about, from company heads to academics to central bankers past and present. Mr Koizumi likes to pick executives for government jobs and there is much to be said for an outsider; but few bosses have the technical skills needed. A professor might have intellectual clout and an outsider's freshness, but would lack political weight—as Mr Koizumi found after he made Heizo Takenaka his financial-affairs minister last year. The odd exception apart, few central bankers—or officials from its rival, the Ministry of Finance—seem keen on radical measures.

A second problem is that any attempt to redirect monetary policy may become bogged down in debates over technicalities or over the precise responsibilities of the central bank. In such a deep crisis, there would seem to be little harm in Mr Koizumi appointing somebody charged, explicitly or implicitly, with generating inflation or driving down the value of the yen. Although the Bank of Japan is independent, the limits on its authority are set by politicians; and independence should be no excuse for bad policy. However, there is sure to be dogged resistance to change. In Japan, no debating point is too trivial if it favours the status quo.

Any attempt to redirect monetary policy may become bogged down in debates over technicalities

Perhaps the biggest doubts surround Mr Koizumi's determination to do what is needed. Granted, in his nearly two years in office he has tried to reform how the government makes decisions, giving more authority to the prime minister and cabinet so that policies are more co-ordinated. Appointing a Bank of Japan governor who will co-operate with broader economic plans, and being explicit about why he is doing so, would help these efforts.

Yet the prime minister has also shied away from bold steps on several occasions, and many are asking whether he will do so again this time. If he really wants to revive the economy, he can choose central bankers who seem determined to get prices rising again, and make his case to Parliament. If he compromises, he will have nobody to blame but himself—and Japan's overdue revival will be delayed even longer.

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The European Central Bank

Trichet on trial

Jan 9th 2003 | PARIS
From The Economist print edition

French justice is finally on the move

EPA

How do I get to Frankfurt?

THE financial cost of the Crédit Lyonnais banking scandal a decade ago may never be known precisely, but is north of *euro*25 billion ($26 billion). Now a court in Paris will determine the human costs. Will these include the fall from grace of Jean-Claude Trichet, governor of the Bank of France and would-be successor to Wim Duisenberg as president of the European Central Bank (ECB)? If so, Europe will have its own central-banking selection problem.

Last year it seemed that Mr Trichet might escape the threat of a belated trial for his role in signing off Crédit Lyonnais's misleading accounts for 1991 and 1992. The bank was then owned by the state and he was the Treasury's director. In July 2002 a public prosecutor ruled that Mr Trichet had no case to answer, apparently signalling his smooth translation from Paris to Frankfurt. However, Philippe Courroye, France's top magistrate, saw things differently. He overruled the prosecutor and ordered Mr Trichet and eight others to stand trial. The case began in Paris on January 6th, amid loud criticism of Mr Courroye's tactics by defence lawyers.

It is difficult to predict how the trial will play out. To be fair to Mr Courroye, the arraigned bankers and bureaucrats were among those most responsible for Crédit Lyonnais's questionable accounts. Arguably the bankers were closer to the underlying fraud than the officials to whom they reported dodgy numbers. At issue is whether the officials, including Mr Trichet, went along with the false accounts so that the bank could mislead international financial markets about its capital adequacy.

The trial should last six weeks, a sprint by French standards. Mr Trichet will thus remain in central-banking limbo until at least the middle of February. He cannot be assured of the ECB post until his name is cleared. If he is convicted, then the French will have to cast around for another candidate of their own—or reluctantly accept a non-French alternative.

Mr Duisenberg has offered to stay on a bit after his planned departure date in July, a gesture presumably designed to rile the French, who originally claimed that he had agreed to stand down last year, halfway through his eight-year term. But the French have looked for a new candidate for months without finding a convincing alternative to Mr Trichet. They are now crossing their fingers and hoping that he gets off the hook.

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Private banking in South Korea

Spoilt market

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Banks are scrambling to serve South Korea's rich—perhaps too eagerly

MOST banks prefer rich customers to poor ones, and South Korea's are no exception. Indeed, their latest fad is private banking—managing the money of the well-to-do—and they are rushing over-hastily to lure clients.

Not surprisingly, South Korea's private-banking market is smaller and less mature than, say, Switzerland's. Private banking is generously defined by Swiss standards: most of the 15 local banks offering "private banking" services seek customers worth more than 100m won ($84,000), far below the sum that would interest a banker in Geneva or Zurich. Korea First, indeed, accepts clients with only 50m won, although Chohung Bank and Shinhan Bank insist on 1 billion won.

Still, the market has promise. In a population of 47m, over 50,000 people have assets of more than $1m, according to one study. The Bank of Korea, the central bank, estimates that the combined savings of those with more than 100m won in their bank accounts amount to $130 billion, an astonishing 55% more than in 2001.

Private banking, a largely fee-based business, ought to reduce the banks' dependence on interest as a source of revenue. It also makes an appealing change from lending to rickety conglomerates, especially when the government is pressing banks to limit loans to households.

In the dull business of looking after money, the banks offer private-banking clients similar, predictable packages, including tax and legal advice, asset management, discounts on certain fees and so forth. Their varying creativity in marketing, however, is remarkable. Clients are plied with everything from free limousine rental (with chauffeur) to matchmaking for their children, health care and even plastic surgery. Some banks have formed alliances with American hospitals.

Clients are plied with everything from free limousine rental (with chauffeur) to matchmaking for their children

Some clients may be impressed; but others are not. "Private banking in Korea can only develop if the clients have the opportunity to purchase sophisticated products", such as instruments linked to stockmarket indices, declared a watcher from UBS, a big Swiss bank, recently. The Bank of Korea issued a warning in October that the local private-banking market needed to mature. It suggested that banks should offer a wider range of services, establish a more secure income base, and tailor their services better to individual clients' needs.

"If competition heats up among banks, private-banking services could impair rather than improve bank profitability," the central bank said, citing as particularly worrisome rising marketing costs and extravagant bonus services. The bank is also vaguely worried that private-banking accounts may be used by money launderers or embezzled by bank employees.

Despite these flaws, western banks, such as Citigroup, are being drawn to the market. They think South Korea's private-banking business will grow as the government deregulates financial markets. The trouble is, they may find that their putative clients have been spoilt by a surfeit of luxuries, with their bankers' compliments.

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About sponsorship

Hedge-fund regulation

At your own risk

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From The Economist print edition

Investors in hedge funds should be able to look after themselves

THE Securities and Exchange Commission (SEC) looks at hedge funds at regular intervals. It reviewed them in 1998 after the near-collapse of Long-Term Capital Management (LTCM). At that time big hedge funds such as LTCM were being watched for the threat they might pose to the stability of the financial system. Today hedge funds are once more in the spotlight, but for less dramatic reasons. A series of minor debacles prompted the SEC to launch a fact-finding mission in May: there are concerns about fraud, bad valuation of net assets, and misrepresentation to investors. The laborious investigation goes on, while investors continue to pour their money into these unregulated beasts. Despite the generally flat performance of hedge funds during 2002, they did better than most other classes of investment.

This week, one big hedge-fund manager, Gotham Partners, said it would close its two main funds, with possible losses to investors. The reasons for Gotham's sudden unravelling are still not entirely clear. On January 7th a judge in New York ordered the distribution to investors of most of what was left of the assets in Lipper Convertibles, a hedge fund that collapsed last year (see table).

The common feature of most hedge funds is that they are unregulated, private investment pools. Their investment techniques differ widely. “Long-short” equity funds, for instance, buy undervalued equities and short-sell those they deem overpriced; convertible-arbitrage funds seek to exploit price differences between pairs of bonds convertible into shares. The riskiness of hedge funds varies widely, from those managed conservatively (mutual funds, in all but name) to those that borrow money to invest three or four times their capital. The great majority of hedge funds are incorporated as limited partnerships offshore and do not report to or register with the SEC, although about 90% of them operate in America.

Giving a dog a bad name

Hedge-fund catastrophes

Sep 1998	Near collapse of Long-Term Capital Management
Jan 2000	Manhattan Investment Fund goes bust with losses of more than $400m
Feb 2002	Lipper & Co admits that one of its hedge funds had lost about 40% of its value, or $315m, in 2001. It had previously reported a gain. Lipper is liquidating all its hedge funds and mutual funds
Oct 2002	Beacon Hill Asset Management admits that its two hedge funds lost 50% of their value, or $400m

Source: *The Economist*

One way to force hedge funds into the regulatory fold would be to require them to register as investment advisers under the Investment Advisers Act (IAA) of 1940. Until now they have been exempt, as they are from the Investment Company Act of 1940 and the Securities Act of 1933. This means that hedge funds cannot market themselves publicly and are required to limit their investors to up to 100 “accredited” investors (earning more than $200,000 a year and disposing of at least $1m in assets), or up to 500 “qualified purchasers” (individuals with at least $5m, or institutions with at least $25m, in liquid investments). The SEC could easily amend these IAA rules. Such a change would make hedge funds more like other investment companies that are overseen and audited by the commission.

In principle, there are three arguments in favour of regulating hedge funds: curbing fraud; achieving greater transparency; and protecting unsophisticated investors. Free marketeers, on the other hand, oppose cumbersome strictures on what they argue is a useful, often counter-cyclical, investment class, now totalling about $500 billion, distributed globally in about 6,000 different funds. This is despite the fact that, even if a hedge-fund manager lies to investors about the value of the fund's holdings, or absconds with the money under management, there is little regulators can do.

In practice, though, fraud is no more frequent with hedge funds than with traditional fund managers, say advocates of the status quo. Investors already benefit from considerable transparency: most funds disclose the salient features of their portfolio monthly to clients. Some even let their clients look at

positions on the internet at all times, with access by password. Moreover, providing obligatory information to regulators has done little to prevent collapses in the past. LTCM disclosed its trades to the Commodity Futures Trading Commission (CFTC)—hedge funds with American clients trading commodity futures or options are not exempt and have to report to and register with the CFTC—but the regulator did not react before LTCM ran into trouble.

In any case, the overwhelming majority of hedge funds' clients are still institutional investors or rich individuals, who are (or ought to be) sophisticated enough to look after themselves. Few tears should be shed for those who lost some of their millions with Beacon Hill Asset Management or in the Lipper fund.

The underlying problem is increasing demand from retail investors. Pensioners and small savers are already investing indirectly through managers of funds that invest in hedge funds (so-called funds of funds). They cannot, at present, invest in hedge funds directly. Most hedge-fund managers do not want them to: they would rather stick to running a few big chunks of money from the rich or from institutions, for administrative as well as regulatory reasons. Many are chary of growing to a size that would hamper their usually flexible and aggressive trading style: though of course some find it hard to turn down new money. Most of all, they would like to avoid being regulated like mutual funds.

Trying to regulate hedge funds carries a big risk, says William Goetzmann of Yale University. All that hedge-fund activity could easily flow into another unregulated format. It is still not clear which way the SEC will jump. The review was launched under the auspices of its former boss, Harvey Pitt, who resigned in November. William Donaldson, the nominated new head of the SEC, may have different priorities.

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About sponsorship

American banking

Loss leaders

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New information measures how much banks really pay to make loans

IN THE three years since Congress abolished the Glass-Steagall act, which had since the 1930s restricted the activities of America's commercial banks, they have often been accused of unfair play. Many of the biggest, it is said, have been using cut-price loans to win lucrative business previously reserved for investment banks.

So what? So a lot, maybe, because commercial banks' deposits are insured by the federal government. Foul, cry investment bankers: money raised cheaply from savers may be subsidising corporate loans. Until recently, though, the only evidence anybody had that something was amiss was tangential: the steady withdrawal of banks such as Mellon, SunTrust, Wachovia and Bank One from lending to companies with which they did not have additional business.

Such suspicions are not new. The “tying” of credit decisions to other business has been prohibited for decades. Any clever banker (abetted by his lawyers) would deny the merest suggestion that his institution was guilty of the practice. Although simple to understand in theory, tying is almost impossible to prove, and the rules can be easily circumvented. It is not illegal, for example, for a bank to review all its business with a client to determine whether to continue lending. Meanwhile, clients are free to say they will engage a bank only in return for (cheap) credit.

Regulators have so far kept quiet, even when petitioned by big investment banks. One reason is that many regulators feel that diversification can do wonders for banks' soundness, even at the cost of a little cross-subsidy. Another is that commercial banks as a whole have not suffered huge credit losses, even though spectacular corporate bankruptcies have raised questions about lending standards. Most important, there is no proof of tying.

Now, however, the evidence that it goes on is looking stronger. Until the end of last year, the most common information on bank loans was provided by the banks themselves to the Loan Pricing Corporation (LPC), which published the results in a weekly newsletter, the *Gold Sheets*. Now the LPC has begun publishing not only the yield of a loan, but also the yield of a bond of similar duration issued by the same company; and the yield a financial institution would receive for assuming the risk of a loan going bad, in the form of a credit-default swap. Morgan Stanley, one of Wall Street's biggest investment banks, has selflessly publicised an index comparing the returns on loans with those on default swaps.

The results are striking. For companies such as General Mills, Eastman Kodak, and Campbell Soup, a lender could earn four times as much from exposure acquired in the secondary market as from participation in an original syndicate, ten times as much through a default swap, and even more by acquiring a bond with a similar maturity. For AOL Time Warner and AT&T, the gap is bigger still.

These numbers ought to be treated cautiously. The markets are mostly illiquid and prices are certainly not precise. Furthermore, lending banks take less risk than other security holders because, in a default, their claims come first. Still, the differences in returns are too large to ignore. Why would a bank charge so little for loans, compared with other forms of exposure to large companies, if it is not getting something in return?

Why would a bank charge so little for loans if it is not getting something in return?

One inevitable consequence is that banks that do not get extra business will opt out of syndicated loans. Indeed, this is already under way. This cannot help the large syndicate managers, such as Bank of America and J.P. Morgan Chase. Banks that genuinely want to earn money from lending will do it where risk-adjusted returns are greatest: that could mean swaps, bonds or the

secondary loan market. The banks that remain in syndicates will expect other compensation than plain old interest payments. In the end, no self-respecting bank will pay its customers to take a loan.

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Enron litigation

Poker games

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J.P. Morgan Chase settles a dispute with 11 insurers

BOTH sides could claim victory in a settlement that had 11 insurance companies paying J.P. Morgan Chase, one of America's biggest banks, 60% on a disputed $1.1 billion surety bond triggered by the bankruptcy of Enron. The deal was struck on January 2nd, a month into a jury trial in New York, during which the insurers claimed they had been misled: they thought they had guaranteed an energy contract, but it turned out to be a loan cunningly disguised to hide the extent of Enron's indebtedness. No matter, apparently, that the insurers' guarantee was documented as “absolute and unconditional”.

Despite evidence that the insurers' agent in Houston knew perfectly well that such contracts were, in effect, loans, J.P. Morgan agreed to accept a reduced pay-out. Its reasoning was that a prolonged jury trial would be risky whatever the merits of its case. The nine-person jury had already dwindled to six. Any further attrition would mean a retrial; and even if all six jurors had remained, J.P. Morgan might not have won. It later turned out that two were firmly for the bank, one less so, and one firmly against; two others did not comment. So taking the offer, 60% of its $965m share of the bond, was probably sound game theory.

The settlement gives little guidance to another claim made by J.P. Morgan against WestLB, a German bank, which has refused to honour a $165m letter of credit that guaranteed Enron's performance on a similar energy contract. WestLB, representing a syndicate of banks, insists that the contract was dressed up as a loan to deceive Enron's creditors and shareholders, and, by the way, innocent German banks.

Performance letters of credit are almost as good as cash, and usually paid without question. But this one was arranged in September 2001, when J.P Morgan had decided it wanted no more surety-bond exposure to a shaky-looking Enron. If there is no prior settlement, the case will be heard before a judge in London's High Court, but not for at least a year.

J.P. Morgan has another gripe with WestLB. The German institution is the only bank not to have paid its share of an identical $150m syndicated letter of credit, which was triggered by Enron's default, and promptly honoured by the arranger: J.P. Morgan.

In the London litigation, a different poker game will be played to that in New York, but internally J.P. Morgan has put a similar discount on its claim. However, depending on the atmosphere at a case-management meeting, scheduled for the High Court in October, that assessment could yet change.

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About sponsorship

Inter-dealer brokers

Voice squad

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Being fully wired is not enough for the world's biggest money brokers

MICHAEL SPENCER is a champion in his field: the broking of complex financial instruments to the world's biggest banks. ICAP, the firm he founded and of which he is still chief executive, is easily the biggest and most profitable of the world's five dominant inter-dealer brokers. It probably made a profit of more than £100m ($150m) in 2002, more than twice as much as its nearest rival, Tullett.

Inter-dealer broking was once the domain of Cockney barrow-boys who applied the nous of the scrap-metal trade to the touting of spot foreign-exchange contracts. Now the barrow-boys have given way to computer geeks and graduates in mathematics, who broker mind-melting derivatives rather than simple spot transactions. Of course, they use computers a lot, but they do the biggest deals the old-fashioned way—by telephone.

A way of life whose days seemed numbered three years ago, because of the advance of dealing platforms that match buyers and sellers electronically, has not only survived, but flourished. Brokers who for a while put their faith in pure electronics have had to dust off their handsets. Tullett made its first annual loss ever in 2000 after going wired. Now, having brought Derek Tullett, its founder, out of retirement to run the show and rearmed its brokers with telephones, it is back on course. It may be bought before the end of this month by Collins Stewart, a cash-rich London stockbroking firm.

Even the purely electronic deal-matching ventures that were started from scratch two or three years ago have concluded that they too need voice contact with the market. One of them, CreditTrade, a credit-derivatives specialist, hired telephone traders from Prebon Yamane, another London inter-dealer broker, after a year of operation. Another, BrokerTec, a bond-broking platform set up by 14 big banks, is being sold to ICAP. Partly, this is because it has run foul of antitrust investigations by America's Department of Justice. However, BrokerTec's owners also recognise that it needs the extra liquidity that voice brokers bring.

Even the purely electronic deal-matching ventures have concluded that they too need voice contact with the market

“The screen gives you a price,” explains Mr Tullett, “but voice gives you the market.” Prices quoted on screens are usually good only for small amounts. It seems that for bigger trades the dealers, even at big banks with every electronic data-feed at their disposal, still yearn for the cocky, ebullient street wisdom of the broker. The market remains, after all, a bubbling cauldron of greed and fear, hubris and hope.

So brokers these days use a mixture of voice and electronics. That said, they believe that more of the less complex trading will be carried out electronically; and the more liquid the instrument, the likelier it is that it will be traded on screens. For example, a few big spot foreign-exchange trades are still done by telephone, but most, perhaps 70%, are done automatically on an electronic brokerage system, known as EBS, built by big banks nine years ago.

Stop me and buy one

That leaves plenty of complex deals to be haggled over by brokers—say a credit-derivative transaction combined with an interest-rate swap and the purchase of bonds, involving several buyers and sellers. In these cases, the broker is a catalyst, coaxing action out of dealers' inertia. The explosive growth of off-exchange derivatives has kept such brokers busy. But they have had to invest heavily in technology to compete, and economies of scale are likely to force more mergers. Mr Spencer sees room for only two or

three global inter-dealer brokers. Although ICAP is the biggest, it should not be complacent, he says.

The battleground has now shifted from derivatives to government bonds. ICAP's bitter rival is Cantor Fitzgerald, which lost many of its top dealers in the World Trade Centre attacks. Cantor now has a 40% share of the American Treasury-bond market, traded mainly on its electronic platform, eSpeed, as well as a good share in German government bonds. ICAP's trading volume in all bonds worldwide, including corporate bonds and mortgages, is about $175 billion a day. That could grow substantially when it buys BrokerTec. BrokerTec's daily volume in American and European government bonds already equals eSpeed's $160 billion, although that includes bond-repurchase agreements (repos), for which volumes may be high but commissions are razor-thin.

Nevertheless, the combination of BrokerTec's bonds and repos with ICAP's dominance in interest-rate derivatives is likely to offer a serious challenge to Cantor on its own turf. In response, Cantor has signed an agreement with the Chicago Board of Trade to add the exchange's electronically traded futures contracts to eSpeed, so that cash and futures can be traded together.

Indeed, brokers and exchanges are converging fast. Both aim to build pools of liquidity. An exchange does that with listed, traditional products; a broker's edge is its ability to handle unusual and one-off deals as well. Both use electronic trading platforms. Brokers, like exchanges, can be exposed to settlement risk, when they briefly act as principal in matching up the two sides of a deal. Both BrokerTec and eSpeed are authorised to operate as futures exchanges in America.

One question is whether inter-dealer brokers might broaden their client base publicly beyond their usual traders. Their heavy investment in trading platforms leads to an inevitable search for bigger economies of scale, with the inclusion perhaps of fund managers, corporate treasuries and hedge funds. For some products, that expansion is already happening. Next stop, investment banking?

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Economics focus

Living in never-never land

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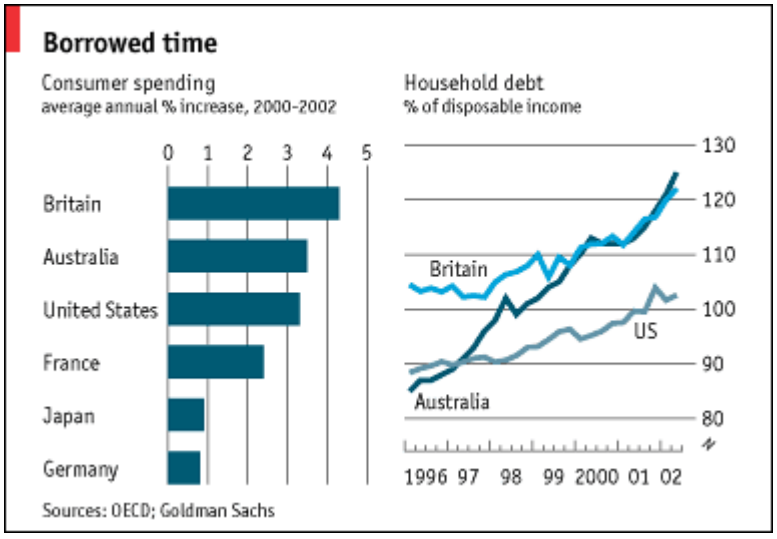
From The Economist print edition

Rising house prices have softened the blow of falling stockmarkets. So far

THREE years of falling share prices might have been expected to force households to tighten their belts. Yet American consumers have continued to spend as if little had changed: their spending has risen at an average annual rate of more than 3% over the past three years. Consumers in Britain and Australia have been on an even bigger binge (see left-hand chart).

In all three countries spending has been partly propped up by rising house prices, which have offset the effect of a decline in equity wealth. Indeed, housing has a bigger impact on spending, because more people own homes than own shares. It has also become easier to turn capital gains into cash by refinancing mortgages. In Germany and Japan, where house prices have been at best flat, consumer spending has been notably sluggish.



But the housing booms have gone hand in hand with a big jump in household debt. The profligacy of American and British households is legendary, but Australians have been even more reckless, pushing their borrowing to around 125% of disposable income (see right-hand chart). In all three countries there are now concerns that unsustainable rates of borrowing will sooner or later end in tears, causing a slump in consumer spending.

Optimists argue that low interest rates justify more borrowing. There is some truth in this: lower rates make a loan cheaper in its early years. But if the main reason for lower rates is lower inflation, the real burden of debt will take longer to pay back. Some borrowers may merely be suffering from money illusion. A more persuasive argument is that debt has been rising relative to income for several decades, as financial liberalisation and innovation have made it easier for ordinary people to borrow. This is not necessarily a bad thing; it can help people to adjust spending over their lifetimes to reflect their preferences.

Thus both home-equity lending and mortgage refinancing, which allow households to tap into the capital gains on their homes, have helped to support consumer spending during the recent downturn. Total "mortgage equity withdrawal" (the increase in mortgage debt in excess of new housing investment) has surged in America, Australia and Britain in the past two years. Most dramatic has been Britain: house prices have risen by more than 25% over the past year, and Goldman Sachs estimates that mortgage

equity withdrawal was equivalent to 8.5% of personal disposable income in the fourth quarter, more than at the peak of Britain's housing bubble in the late 1980s. In America and Australia, mortgage equity withdrawal has been running at a record 4% of disposable personal income.

Falling interest rates and rising house prices have allowed millions of homeowners to take out bigger mortgages without increasing their debt-service costs. How long can this continue? If house prices fell, some people would clearly be in trouble, because their homes would be worth less than their mortgages. In real terms house prices in America, Britain and Australia have risen more rapidly in recent years than during the late 1980s house-price boom, leaving prices close to record highs in relation to both rents and household incomes. On the other hand, low interest rates make mortgages more affordable, and many economists take comfort from the fact that interest rates look unlikely to rise significantly in the near future. They conclude that, although house-price inflation is likely to slow, prices will not actually fall, so there is no need for consumers to retrench.

Consumer spending could, however, weaken even if the house-price bubble does not burst. All that is needed is a slowdown in the pace of mortgage equity withdrawal. An analysis by Jan Hatzius, an economist at Goldman Sachs in New York, shows that the pace of mortgage equity withdrawal depends on changes in interest rates and house prices, not on their levels. Once interest rates have been historically low for a while, most homeowners wanting to refinance their mortgages will already have done so; even if rates remain low, therefore, equity withdrawal will decline.

The implication is that it would require continued rapid gains in house prices and continued falls in interest rates to sustain the pace of mortgage equity withdrawal at current levels. It seems unlikely that house prices can continue their recent gallop, and in most countries there is little room for a further big fall in interest rates. Thus, even if house prices do not plummet and interest rates do not rise, but both merely stabilise, the boost to consumer spending will surely fall away.

Some home truths

Mr Hatzius offers a stylised example: suppose you earn $40,000 a year, your home is worth $200,000 and your mortgage is $100,000 at a 6% interest rate. Interest rates then fall to 5%, allowing you to borrow another $20,000 without any increase in your debt-service costs. As a result, you now have total spending power of $60,000 ($40,000 plus $20,000). You use $20,000 to buy a new car. Next year, house prices remain flat and interest rates are unchanged. With no new home equity to extract, your spending drops to $40,000. This is an extreme example; you might not blow all your extra spending power at once, and at the economy-wide level the effects would be nowhere near as large. But it illustrates how households that have cashed in on higher house prices may have to cut back even if those prices do not drop. If enough do so, it could tip an economy into recession.

The two main drivers of higher borrowing and spending, rising house prices and falling interest rates, are likely to peter out in America before they do in Britain or Australia. American house-price inflation had already moderated to 6% in the year to the third quarter and the Fed has less room to cut interest rates than other central banks do.

Consumers have been living on borrowed time. The bursting of the share-price bubble and the consequent slump in wealth required them to save more. Rising house prices have allowed them to postpone that adjustment, helping to prop up demand. Sooner or later consumers will have to face up to reality.

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About sponsorship

Planet hunting

In transit

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Astronomers use a hot new technique to discover the hottest known planet

MONDAY January 6th passed uneventfully on planet OGLE-TR-56b. As usual, it was beastly hot, at 1,600°C, and it was raining molten droplets of iron. Dusk brought no relief, because there was no dusk. The planet's sun-like star never sets—and it is so close that it looms as large as a dinner plate held at arm's length.

Meanwhile, on a cooler planet located one spiral arm farther out from the centre of the galaxy, in the unsunny city of Seattle, astronomers were announcing OGLE-TR-56b's discovery. The planet has the fastest and smallest orbit of any of the 100 or so Jupiter-like gas balls that have recently been found orbiting stars other than the sun. Its year—the time taken to complete one orbit—lasts only 29 hours. Its parent star probably pulls hard enough to synchronise OGLE-TR-56b's spin with its orbit (much as the earth does to the moon), causing one side of the planet to be in perpetual daylight.

Ogling the sky

Of greater significance is how the new planet was discovered, according to Dimitar Sasselov of the Harvard-Smithsonian Centre for Astrophysics, in Cambridge, Massachusetts, who made the announcement at the American Astronomical Society meeting in Seattle. Its presence was betrayed by a decrease in light from OGLE-TR-56b's parent star when the planet moved in front of that star. This is a technique that could eventually reveal hundreds more planets, including small, rocky ones similar to the earth.

Such tiny specks of rock can never be found using the traditional method of planet-hunting, the “Doppler technique”. The signal that astronomers habitually sought is the to-and-fro wobble of a star caused by the tiny gravitational tug of an orbiting planet. A mass as puny as the earth's would not move a star any more than the random boiling motions of a stellar surface. However, an earth-sized obstacle would reduce the star's light by 0.01%. This may sound small but it is large enough to measure.

On that scale, spotting OGLE-TR-56b was a cinch; a giant by terrestrial standards, it covers 1% of the face of its parent star. This dip was first noticed by Andrzej Udalski and his group at Warsaw University. They included it in a list of 59 possible cases of stars with planetary eclipses (known as “transits”) that the group found while monitoring the brightness of 50,000 stars using a telescope in Chile. Dr Udalski's

group, called OGLE (the Optical Gravitational Lensing Experiment, a name that reflects the original, and different, purpose of the survey), made their list public in February 2002.

A race then began to work out which of the 59 cases were genuine planetary transits, and which were false positives: eclipses due to companion stars, for example. The winners of the race, Dr Sasselov, together with Guillermo Torres and Saurabh Jha, his colleagues at the Harvard-Smithsonian, and Maciej Konacki of the California Institute of Technology, used the Doppler technique to work out the mass of the obstructing object in each case. In one system they confirmed that the object was unambiguously a planet.

Although Doppler confirmation was required, the transit method may turn out to have wider application. The Doppler method requires intensive monitoring by the world's largest telescopes, and works only with the brightest stars. Transits can be spotted using telescopes no bigger than those available in department stores. This means that the transit method can be used on fainter and more distant stars, increasing the volume of space that can be searched for planets by a factor of more than 10,000. An example of things to come, OGLE-TR-56b is the most distant planet known, almost 5,000 light-years away, as well as being the hottest and closest to its parent star.

That increase in range makes up for the fact that only planets with orbital planes edge-on to the earth's can be detected by the transit method. And although false-positive transits still have to be ruled out using the Doppler method, those follow-up measurements need not be as precise as the measurements needed to detect something with the Doppler method in the first place. As a result, they take much less time—a crucial advantage, because big-telescope time is, to an astronomer, more precious than gold.

Too close for comfort

What of OGLE-TR-56b itself? Many of the Jupiter-like planets found previously by the Doppler method also hug their stars closely. At first these discoveries were surprising. It was thought a gas ball such as Jupiter could not condense in such hot surroundings. What is more, the pattern does not conform to the assumed normal pattern of rocky inner planets and gaseous outer planets (as found in the earth's solar system). Now, astronomers have come to terms with the idea that it is our local arrangement that is unusual. Although the gas balls certainly form some distance from a star, where things are reasonably cool, they then spiral inwards due to interactions with the discs of dust and gas that surround stars for a few million years after they are born.

This idea could explain most of the properties of the newly-discovered planets. Among these properties was the finding that many planets have orbits as small as 4% of the diameter of the earth's but none has an orbit smaller than that. This, the theory went, was because the new star's intense radiation drove away any dust and gas within such a range, preventing planets from spiralling any further inwards. Unfortunately for the theorists, the orbit of OGLE-TR-56b is 2.5% of the diameter of the earth's—so they must now go back to the drawing-board.

New gas balls are always welcome. The transit method's real prize, though, would be the detection of earth-sized bodies. Despite the method's sensitivity, this will require the use of space-based telescopes, to iron out the effects of the earth's atmosphere. Both NASA, America's space agency, and ESA, its European counterpart, plan to launch telescopes dedicated to this task by 2007. If earth-like planets are common, these telescopes will find dozens of them, as well as hundreds more Jupiter-like gas balls.

The logic of transit searches might also help those searching for radio signals from extraterrestrial civilisations. Adam Kampff, an undergraduate at Harvard, says that the aliens most likely to transmit signals towards the earth would be those who know that the earth exists. And they will be the aliens who are in the right places in the galaxy to detect the earth transiting the sun. Aim your radio dish at stars which view the earth's orbit edge-on and you have a better chance of making contact with anything that is out there.

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Gravity

Jupiter calling

Jan 9th 2003
From The Economist print edition

Scientists have at last measured the speed of gravity

Fast food

ONE of the last untested predictions of Einstein's general theory of relativity is that gravity should travel at the speed of light, rather than infinitely fast, as Newton supposed. Scientists had thought that the best way to measure gravity's speed would be to use gravitational waves. These waves, like ripples in a pond, are produced when a mass accelerates, but they are currently undetectable. Now a team from the University of Missouri and America's National Radio Astronomy Observatory in Charlottesville, Virginia, have found a cleverer way to test the prediction.

Their results, presented on January 7th at the Seattle meeting of the American Astronomical Society, describe a measurement made last September, when Jupiter passed in front of a quasar. Because quasars are among the most distant, and brightest, objects in the universe and Jupiter is one of the nearest, the researchers realised that this occultation would produce detectable effects that depended on the speed of gravity.

Quasars give off highly energetic radio waves. Jupiter, as it passed in front of the quasar, bent these radio waves with gravity. Because Jupiter was moving, the amount by which the waves were bent depended not only on its position, but also on how long it took Jupiter's gravity to reach the radio waves as they travelled toward the earth. Earlier measurements were sensitive only to the bending. Using an array of radio telescopes scattered across the United States, from Hawaii to the Caribbean, as well as another telescope in Germany, the team made very precise measurements of the quasar's apparent position. This allowed them to confirm, although only to an accuracy of 20%, that the speed of gravity is indeed the same as that of light. More precise measurements are still to be made, and astrophysicists hope to observe gravitational waves directly within the year. For the moment, though, Einstein can sleep easy.

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Bjorn Lomborg

Thought control

Jan 9th 2003
From The Economist print edition

The scourge of the greens is accused of dishonesty

THE Bjorn Lomborg saga took a decidedly Orwellian turn this week. Readers will recall that Mr Lomborg, a statistician and director of Denmark's Environmental Assessment Institute, is the author of “The Skeptical Environmentalist”, which attacks the environmental lobby for systematically exaggerated pessimism. Environmentalists have risen as one in furious condemnation of Mr Lomborg's presumption in challenging their claims, partly no doubt because he did it so tellingly. This week, to the delight of greens everywhere, Denmark's Committees on Scientific Dishonesty ruled on the book as follows: “Objectively speaking, the publication of the work under consideration is deemed to fall within the concept of scientific dishonesty.”

How odd. Why, in the first place, is a panel with a name such as this investigating complaints against a book which makes no claim to be a scientific treatise? “The Skeptical Environmentalist” is explicitly not concerned with conducting scientific research. Rather, it measures the “litany” of environmental alarm that is constantly fed to the public against a range of largely uncontested data about the state of the planet. The litany comes off very badly from the comparison. The environmental movement was right to find the book a severe embarrassment. But since the book was not conducting scientific research, what business is it of a panel concerned with scientific dishonesty?

One might expect to find the answer to this question in the arguments and data supporting the ruling—but there aren't any. The material assembled by the panel consists almost entirely of a synopsis of four articles published by *Scientific American* last year. (We criticised those articles and the editorial that ran with them in our issue of February 2nd 2002.) The panel seems to regard these pieces as disinterested science, rather than counter-advocacy from committed environmentalists. Incredibly, the complaints of these self-interested parties are blandly accepted at face value. Mr Lomborg's line-by-line replies to the criticisms (see www.lomborg.com) are not reported. On its own behalf, the panel offers not one instance of inaccuracy or distortion in Mr Lomborg's book: not its job, it says. On this basis it finds Mr Lomborg guilty of dishonesty.

The panel's ruling—objectively speaking—is incompetent and shameful.

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Autism

Out of the deep freeze

Jan 9th 2003
From The Economist print edition

New research hints that autism may be several disorders, not one

BY THE time an autistic child reaches its second birthday, the parents usually know that something is wrong. But there are no biological markers of autism. Instead, doctors diagnose it using a set of behavioural indicators—such as a failure to make eye-to-eye contact in social interaction—that have evolved over the six decades since the term “autism” was first applied to childhood disorders of social interaction.

Autism involves an impairment of normal social interaction and communication. It is often associated with repetitive behaviours and restricted interests. There is still little understanding of what causes the disease, of how to treat it, or of why it is three times as common in boys as in girls. Curiously, the disorder knows no racial, geographic or social boundaries. It is also very variable. Some autists require a lot of care. Others, though they may struggle with social interactions and have strange hobbies or obsessions, are intelligent enough to find strategies to cope.

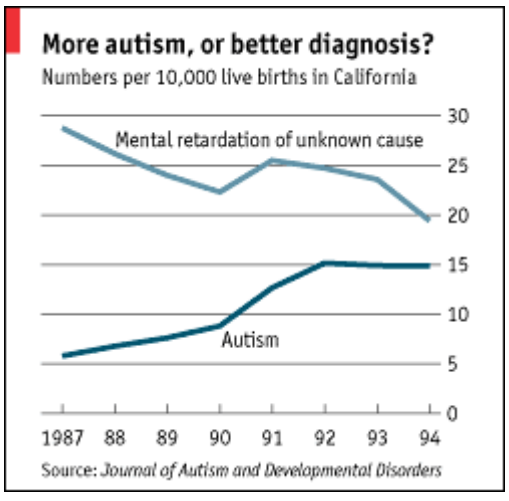
In an attempt to draw together the threads of modern understanding about autism, the Royal Society has devoted an entire issue of one of its journals, *Philosophical Transactions B*, to the topic.

In the genes

According to Elisabeth Hill and Uta Frith of University College, London, the editors of the issue, one of the biggest recent changes in the understanding of autism has been the discovery that it has a large heritable component. If one member of a pair of identical twins is autistic, in 90% of cases the other twin will be as well. In non-identical twins the figure is 10%. That understanding alone is clearly an advance. The problem is that anything from two to ten interacting genes could be involved in the development of autism.

An environmental component has also been suggested as a possible explanation of why cases of autism seem to be on the increase. A study conducted in Atlanta in 1996, and published this month in the *Journal of the American Medical Association*, showed that cases of autism had increased tenfold over the previous decade. The disease is no longer considered rare: one new estimate puts it at at least 0.6% of the population.

There is, though, evidence that this increase is due to changes in diagnosis. Research carried out last year in California (see chart) certainly showed an increase in cases of autism, but it also showed an equivalent decline in cases of “non-specific mental retardation”. In other words, it seems that children who would once have been labelled “retarded” are now more likely to be given the more specific diagnosis of “autistic”. This is partly because diagnostic criteria have broadened over the years. The beginning of the rise in diagnosis also precedes the introduction of combined measles, mumps and rubella vaccines, which some have suggested may help to trigger the disease.



Even before the criteria for diagnosis were broadened, though, autism was known as a highly variable disorder. One new idea is that autism may not be a single disease but several. The label autism may mask scientific ignorance about what is a set of

symptoms with different causes.

One controversial subgrouping already exists: Asperger's syndrome. This term is applied to the symptoms suffered by those with social impairments, but who show no delay in the development of linguistic and cognitive abilities as children. But diagnoses based only on behaviour are probably not getting at the whole truth. Combining them with looking inside the brain may be more revealing.

This was done in another paper in *Philosophical Transactions B*. Helen Tager-Flusberg and Robert Joseph of the Boston University School of Medicine, used magnetic-resonance imaging (MRI) to calculate differences in the volumes of different parts of the brains of autistic children. One group could be identified by large discrepancies between verbal and non-verbal intelligence (non-verbal intelligence is measured by puzzles and pattern-related tasks). In normal children verbal and non-verbal intelligence are about equal. The second group was children with language impairments.

In the first group, the level of non-verbal intelligence was in turn related to larger head size and brain volume. Intriguingly, it was also related to the severity of the symptoms—the more non-verbally intelligent, the more autistic. In the second group, both brain structure and behavioural characteristics were very similar to children with another disorder known as specific language impairment, which is a delay in language development.

More support for the idea that there are different types of autism comes from another MRI study. This was done by Claire Salmond of Addenbrooke's Hospital in Cambridge. One of the more prominent ideas about autism is that damage to the amygdala, a pair of structures in the middle of the brain that are involved in processing emotions, is central to the disorder. Using MRI, Dr Salmond and her colleagues found that only half of a group of autistic children showed damage to this region. By contrast, they found that changes to other structures in the brain, including the orbitofrontal cortex, cerebellum and superior temporal gyrus, were more consistently associated with the disease—although not in all children. These structures have many functions and it is not known how they may cause autism; but they will help scientists find autistic subgroups.

Secrets of cognition

Yet another way of picking apart the causes of autism is to look at cognitive differences between autistic and other children. Simon Baron-Cohen and his colleagues at Cambridge University have found that adults with autism show an unusually strong drive to “systemise” the world around them. Even in normal populations, men are more prone to systemise than women; conversely, women are more able to empathise—or identify mental states and respond with an appropriate emotion—than men. Successful social interaction usually involves empathy. The finding that autists tend to systemise provides support for Dr Baron-Cohen's theory of the origin of autism. This is the “extreme male brain” theory, that autism is a magnification of normal male mental traits. The trigger, and the explanation of why girls are affected too, may be exposure to abnormally high levels of testosterone in the womb.

Our understanding of autism has come a long way since the days it was believed that “refrigerator mothers” were responsible for autism. Cold, unloving, and often working women were blamed for their children's impairment. Today's parents know they are not at fault, but they are still waiting to find out what is.

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About sponsorship

Los Angeles

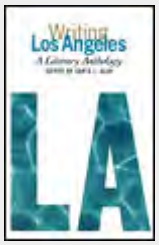
In its own image

Jan 9th 2003
From The Economist print edition

A treasure trove of writing from one of the world's great cities

THIS excellent anthology reminds us that, artistically speaking, there is more to Los Angeles than movies. The city has inspired a remarkable amount of enduringly good writing. David Ulin, a local journalist, has brought together short stories, essays, diary entries and poetry by more than 70 authors. The result is both an engrossing sampler of the city's many literary voices and an informal survey of its rich cultural history. We get just about everything from 1880s nostalgia for Spanish missions to the arresting claim that the city is "as clear an image as exists today of the world we are about to enter".

Writing Los Angeles
Edited by David L. Ulin



The Library of America; 880 pages; $40

Buy it at
Amazon.com

The uniqueness of the place is hard to pin down. Just defining its borders can provoke erudite rows. It is partly the scale. The city is sprawling, fragmented and centreless. But having no *plaza mayor* (have London, New York or Paris?) doesn't mean having no identity. The best pieces here are those which highlight the city's diversity and try to explain its distinctiveness.

For Reyner Banham, Los Angeles is a giant museum of architectural styles, some new, some backward looking, but all exuberant and exciting. Its finest buildings he finds ingeniously suited to their setting and purpose—the hat-shaped Brown Derby restaurant (now demolished) no less than the hard-edged but radiant Water and Power Building. Tom Wolfe, too, is good on the city's looks, admiring the flamboyant lettering on the billboards that loom over the North Hollywood streetscape: "horribly slick dog-legged shapes" that he calls "boomerang modern".

For others, the city's natural environment looms as large as the man-made one. Gary Snyder evokes in verse the interplay between the two. Robert Towne, who wrote the screenplay for "Chinatown", one of the great Los Angeles movies, remembers the soft-toned city of his childhood, where "you could stand on the Palisades overlooking Portuguese Bend and have all the dry desert breeze at your back abruptly splashed with salt air from the sea crashing on the rocks and swirling tidepools a hundred feet below." Lawrence Weschler, a *New Yorker* journalist, asks locals about the quality of the city's light and gets some wonderfully vivid responses: "The light, clear as stone-dry champagne, after a full day of rain...that's the light that breaks hearts in LA."

John McPhee by contrast gives an uncomfortable sense of what it is like to live in a disaster-prone city

hemmed in by desert, ocean and mountains. As well as having to endure the four seasons of flood, fire, drought and earthquake, Angelenos are regularly buffeted by the Santa Ana, an enervating desert wind. The effects of the Santa Ana have never been more memorably described than in the opening sentences of Raymond Chandler's early detective story, “Red Wind”: “Meek little wives feel the edge of the carving knife and study their husbands' necks.” Although he was an outsider, like so many of those who have written well about the city, Chandler's remains a quintessentially Los Angeles voice. In the city's complexities and calamities, he discovered a perfect match for his much-imitated prose: edgy, ironic, meticulously attentive to surface detail, faintly menacing.

Certain deep social currents tug away in this collection as well, particularly the volatile question of race. It links pieces on California's native Indians, Filipino immigrants, the persecution of Mexican zoot-suiters in the 1940s and the riots in black neighbourhoods in the 1960s and 1990s.

Los Angeles has always had eloquent detractors, and much of their mud has stuck. “Here is the world's prize collection of cranks and semi-cranks, placid creatures whose bovine expression shows that each of them is studying, without much hope of success, to be a high-grade moron, angry or ecstatic exponents of food fads, sun-bathing, ancient Greek costumes, diaphragm breathing and the imminent second coming of Christ.” That was a future editor of the *New Republic*, Bruce Bliven, writing in 1927; but it could have been written yesterday. Clichés are tenacious, and Los Angeles has been burdened with its share—the price one metropolis pays to another, and to the provinces.

Even now, Los Angeles rarely gets the attentive ear it deserves. “Writing Los Angeles” goes some way—at nearly 900 pages, actually quite a long way—towards putting that right.

Writing Los Angeles.
Edited by David L. Ulin.
The Library of America; 880 pages; $40

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About sponsorship

Enron

Hearing the splash

Jan 9th 2003
From The Economist print edition

AFTER the fall come the books. And nothing recently in the corporate world has fallen quite so spectacularly as Enron, the Houston-based oil-and-gas company that flew so high it made Icarus look like a grasshopper. Enron scorched to earth in December 2001 when it was forced to seek protection from its creditors under Chapter 11 of America's bankruptcy code. Thousands of employees lost their jobs and their pensions (largely invested in worthless Enron stock) while the designers and polishers of its wings of wax walked away with tens of millions of dollars each.

Not a pretty tale. Of the many tellings of it, these are currently the two most popular. In the absence of any input from the leading characters—the chairman and founder Kenneth Lay, the chief executive Jeffrey Skilling and the chief financial officer Andrew Fastow, all of whom are keeping mum in view of pending lawsuits—authors must tackle their subject somewhat indirectly.

These two take rather different routes. Robert Bryce is a Texan journalist with a feel for the place and climate of his subject. He brushes past the (not inconsiderable) technical complexities of Mr Fastow's off-balance-sheet schemes and heads straight for the personalities. This is not “Dallas”, but it's not far off. It's dead flat, air-conditioned Houston, where the town's big rich (and they don't get much bigger) live in River Oaks, a district whose architecture was once described as “Ralph Lauren meets Scarlett O'Hara”. Enron's top executives all made it to River Oaks, and Mr Bryce obligingly provides us with a map to show where they are.

As he describes them, they are almost unremittingly awful. One of them that he met “reminded me that being a Texas-sized sphincter was valued at Enron”. After a while, though, his litany of their adultery and greed seems unbalanced. Surely there were some redeeming features? Surely the whistle-blowing accountant, Sherron Watkins, was not merely seeking to further her own career when she exposed Mr Fastow's accounting tricks? And what about J. Clifford Baxter, the Enron vice-chairman who shot himself a year ago leaving a suicide note for his wife in which he said: “I have always tried to do the right thing, but where there was once great pride now it's gone...please try to forgive me.” Mr Bryce leaves no room for atonement.

AP

Lay played it by his book

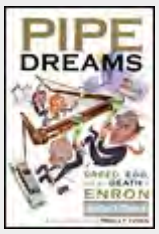
Loren Fox is a business writer who does not shy away from the complexities of Enron's business and financial dealings. On occasions, though, their details hold up the flow of his story. Especially before he gets really rolling with a perceptive chapter called “Culture of Creativity?” Here he describes the change in Enron's corporate culture, wrought largely by Mr Skilling who once said that he wanted his “best people to wake up at three o'clock in the morning in a cold sweat”. And not because they'd left the air-conditioning on.

Enron: The Rise and Fall
By Loren Fox

John Wiley; 384 pages; $24.95 and £17.50

Buy it at
Amazon.com
Amazon.co.uk

Pipe Dreams: Greed, Ego, Jealousy and the Death of Enron
By Robert Bryce



Public Affairs; 320 pages; $26 and £8.99.

Buy it at
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Amazon.co.uk

There is a peek into Enron's notorious twice-yearly Performance Review Committee meetings. Known as rank and yank, they consisted of a group of senior managers getting together in a hotel for a week or so, ranking employees according to various criteria, and then sacking the bottom 10-20% of them. But don't worry. The moral of the story is, it didn't work.

On one critical event in the Enron story both books agree. If there was a no-turning-back moment for the company it was the resignation in 1996 of the chief operating officer, Richard Kinder (pronounced “Kinnder” and referred to in one book as Rick and in the other as Rich, suggesting he has not talked to either author). Mr Kinder had been the hands-on counterbalance to Kenneth Lay's networking with the rich and powerful (President George W. Bush called him “Kenny Boy”). Mr Kinder kept a keen eye on the cashflow and frowned on extravagance. But he was replaced by Mr Skilling, whose eyes, as we now know, were elsewhere.

Enron: The Rise and Fall.
By Loren Fox.
John Wiley; 384 pages; $24.95 and £17.50

Pipe Dreams: Greed, Ego, Jealousy and the Death of Enron.
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About sponsorship

Defending classical music

All of us

Jan 9th 2003
From The Economist print edition

IN THE early 17th century, a poet stirred by the rich polyphony of church music declared that it showed him “the way to heaven's door”. Three hundred years later, another poet heard in a Beethoven symphony “mankind made plausible, his purpose plain”. Unhappily, reactions to classical music in our time are often less visionary. Miles Davis, a noted jazz trumpeter who turned to rock, pronounced it “dead shit”, lacking the instant impact which pop music offers and which pop culture of all kinds has made the global measure of emotional effect.

As indifference to classical music grows, Julian Johnson, an academic and composer, has produced a heartfelt and finely reasoned appeal. “Who Needs Classical Music?” not only makes the case for the relevance of its subject, but launches a larger attack on attitudes which threaten to marginalise both classical music and high art in general, replacing their unique depth with the frissons of fashion and sensation. For Mr Johnson, mainstream culture has become saturated with the youth values of immediacy and novelty. Geared to commodities and advertising, it dismisses the more deliberate and complex responses which classical music requires as outmoded, unsellable and elitist.

Who Needs Classical Music? Cultural Choice and Musical Values
By Julian Johnson

Oxford University Press; 152 pages; $22.95 and £18.99

Buy it at
Amazon.com
Amazon.co.uk

Indeed, so as to survive, classical music has in places begun to adopt the trappings of pop. Classical charts are dominated by easy-listening compilations, crossover albums, tie-ins with films and ad campaigns, and photogenic young performers of frequently limited talent. The one way for core classical repertoire to achieve hit status is by hype of its own, as in the recent recording of Mahler's Fifth Symphony by the Berlin Philharmonic and its charismatic new conductor, Sir Simon Rattle.

But even this kind of appeal has more to do with media than music. Mr Johnson is concerned that some people who profess a fondness for classical music are really more attracted by its image, staking a snobbish claim to what is perceived as an elite activity without making the effort of attention which classical music depends on and radically repays.

The very ubiquity of music in the modern world is part of the problem. Mr Johnson regards recording as a double-edged sword—excellent for making masterpieces available at the touch of a button, deleterious as an encouragement to treating them merely as an agreeable background noise to suit a mood, while away the time, half-ignore and interrupt at will.

At the heart of Mr Johnson's argument is this sense that the classical impulse is different from simple entertainment. Classical music offers not merely the basic pleasures of melody, harmony and rhythm, but the meanings which these elements can reveal when explored in the process of composition by a master. It is just this intense emotional and intellectual engagement, shared by composer and listener, that pop music and pop culture reject: it is definitely not cool, a quality which denies complexity, in which work followed by chilling out define the parameters of being human.

By contrast, Mr Johnson's idea of humanity is inherently complex and uniquely fulfilling, involving “the tension between the bodily and the intellectual, the material and the spiritual, the thing-like and its transcendence in thought.” Throughout the ages, people have sought to reconcile their dialectical nature, and classical music offers the means of resolution. From Bach to Beethoven, Brahms to Alban Berg, its mysterious processes engender “a squaring of the circle that we claim as fundamentally human. We understand ourselves as particular, physical beings, but we also value the ways we exceed the physical, the ways our capacity for thought, feeling and imagination seem to transcend our bodily existence.”

Mr Johnson insists that this experience is not remotely elitist, but part of a natural human desire to possess more life, in more comprehension and abundance. His wise, perceptive and inspiring book provides something of the same humanising effect, as well as passionately answering the question in its title.

Who Needs Classical Music? Cultural Choice and Musical Values.
By Julian Johnson.
Oxford University Press; 152 pages; $22.95 and £18.99

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About sponsorship

Modern farming

Harrowing

Jan 9th 2003
From The Economist print edition

WHY was Thomas Malthus (1766-1834) so wrong when he predicted population growth would inevitably outstrip food production? Why has precisely the opposite happened in western Europe and North America, where governments now struggle to cope with food surpluses, not the mass starvation foreseen by the gloomy economist-cleric?

With the aid of charts and statistical tables, Bruce Gardner, a professor of agriculture at Maryland University, shows how innovations beyond Malthus's wildest imaginings turned the United States into the world's agricultural superpower. Labour productivity soared phenomenally during the last century—fiftyfold, for example, for both cotton and corn—as tractors, combine harvesters, cornpickers and other machinery supplanted farm workers and draught animals. In 1900, American farmers owned 20m horses and mules; by 1960, when statisticians stopped counting them, only 3m.

Increases in land productivity were impressive, too. Hybrid seeds produced seven or eight bushels of corn where one grew before. Cross-breeding and artificial insemination helped breeders rear dairy cows carrying so much milk that they waddled into milking parlours. And further large increases in production are in prospect during the 21st century through genetic-engineering, embryo transplants and cloning.

Mr Gardner concedes that consequent food surpluses have led farmers to lobby successfully for domestic price supports, import restrictions and export subsidies, but the overall tone of his book is triumphalist. For him, it is a cause for celebration, not regret, that innovations in technology have “tremendously increased the size of operation a farmer can feasibly run” and that 150,000 big farms account for 85% of America's agricultural output.

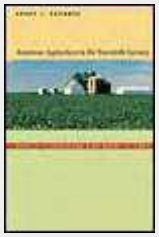
The broader consequences of the intensive farming of crops and the factory farming of animals are more immediately felt and consequently more openly controversial in a small country. “Remaking the Landscape” is a collection of essays about the pressure on the land in Britain. Most contributors are keen on biodiversity, worried about the health hazards of chemicals and biotechnology, and mistrustful of agribusinesses.

The quality of their writing is, to be charitable, mixed. The black-and-white photographs lack the impact of colour ones. But the greens here nonetheless make their case. It is hard to see the point of costly agricultural policies that encourage ever more intensive farming when Britain and its European partners need their farmers to produce less, not more.

American Agriculture in the Twentieth Century: How It Flourished and What It Cost.
By Bruce L. Gardner.
Harvard University Press; 400 pages; $49.95 and £33.50

Remaking the Landscape: The Changing Face of Britain.
Edited by Jennifer Jenkins.
Profile Books; 298 pages; £20

American Agriculture in the Twentieth Century: How It Flourished and What It Cost
By Bruce L. Gardner



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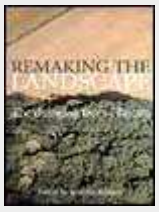

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New fiction

A haiku in ice

Jan 9th 2003
From The Economist print edition

WITH one novel about genetics and another about ancient papyrus scrolls, it is no wonder that Simon Mawer has a reputation for being a brainy read. But that is to ignore the emotional richness of his writing.

In “The Fall” he returns to earlier themes—love, betrayal and the search for truth. When an acclaimed climber, Jamie Matthewson, is killed near his home, his estranged childhood friend, Rob Dewar, heads immediately for north Wales to visit Matthewson's widow, Ruth. The clouds surrounding the personal and physical peaks the three have scaled since childhood gradually part as the story seesaws between the present day and the earlier generation; Jamie's father, also dead on a mountain, and his parallel relationships with both Jamie's mother and Rob's.

In less talented hands, the writer's quest to capture the intense, elusive allure of mountains might well overwhelm a quiet novel. But Mr Mawer is well aware of the metaphorical significance of struggle. His settings are finely painted with the colours of time: neon today, gravy-brown for 1950s Britain. His men are boyish, competitive; his women on the wary side of dishonest. And his narrative surges with an energy that thrusts the story forward to the very last page, from which a startling new light shines on all that has gone before.

The Fall.
By Simon Mawer.
Little, Brown; 384 pages; $24.95
£12.99

The Fall
By Simon Mawer

Little, Brown; 384 pages; $24.95

Buy it at
Amazon.co.uk

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New films

Getting personal

Jan 9th 2003 | LOS ANGELES
From The Economist print edition

Two prominent directors look back on their youth in their latest work

"CATCH Me If You Can" by Steven Spielberg has struck fans as a welcome change from Auschwitz ("Schindler's List"), D-Day ("Saving Private Ryan") and a matched set of future dystopias dreamed up by Stanley Kubrick ("AI") and Philip K. Dick ("Minority Report"). But those grimly ambitious films probably made this flawless light entertainment possible. Having grown up at last in his medium—film is the one life he has known—the wunderkind, who turned 56 in the week his newest film opened, can indulge in nostalgia about his salad days.

In recounting the exploits of Frank Abagnale (Leonardo DiCaprio), a con man of the 1960s who wrote bad cheques worth $4m before the age of 20, Mr Spielberg is recalling youthful chutzpah of his own that has since brought him to an eminence where he can legitimately withdraw that sum from petty cash whenever he chooses.

Abagnale, tired of living with his divorced father (Christopher Walken), underwrote his "paper-hanging" exploits by masquerading as an airline pilot, a lawyer and a doctor. An early Spielberg story is that, unable to get into a decent film school, he made Universal Studios his university by donning a suit and tie, finding an empty office and attaching a fake nameplate to the door.

The truth is less romantic, but almost as impressive, and "Catch Me If You Can" permits the film-maker to "print the legend" in pastel-coloured 1960s images of debonair Frank conning his way into the good life at the very time spindly young Steven, not yet out of college, was walking up to Cary Grant on the Universal lot and inviting him to lunch (Mr Grant accepted).

As it happens, the future mogul was also living with his divorced father, who booted him out for neglecting his studies. He found a surrogate father in the black-suited Universal executive who gave him his first directing contract; in the film, Frank's mentor is a black-suited FBI nerd (Tom Hanks with a spare tyre and a Boston accent), who spends the entire film trying to catch his flamboyant nemesis and being outwitted at every turn.

Like Mr Spielberg's first film, "Duel" (1971), "Catch Me If You Can" is also a live-action version of those cartoons in which the uncatchable Roadrunner eternally eludes the famished Coyote, with a twist at the end that Freud would have relished: the FBI man becomes Frank's guide, pointing him toward a legitimate career where he can use his criminal gifts to make millions. The snazzy 1960s-style animated titles of Mr Hanks's silhouette pursuing Mr DiCaprio's pay tribute to the film's cartoon origins, and to a more innocent-seeming era: today a rogue like Frank would probably be nailed by a computer before the glue dried on his first fake ID.

Dark days

"The Pianist" is the film Roman Polanski has long wanted to make about the Holocaust in Poland, which he lived through as a child. He finally found a cinematic home for those haunting memories thanks to a memoir written by the great Polish pianist Wladyslaw Szpilman, who survived the Warsaw ghetto. Mr Polanski's family was interned in the Krakow ghetto before all but the boy were sent to a camp, but the film-maker's account of the period in his memoirs is eerily like Szpilman's. The main difference is that Mr

Polanski was coming of age while evading death at the Nazis' hands, and Szpilman (a gaunt, sad-eyed Adrien Brody) is already a great artist when he and his family are ordered to move to a cramped apartment in the so-called small ghetto reserved for well-to-do Jews, who are thus encouraged to think of themselves as relatively fortunate.

The illusion of safety evaporates in a stream of vignettes with no dramatic demarcations but the inexorable march of dates flashed on the screen. Following a scene where family members vow never to wear the Jewish star, we see the father, wearing an armband obviously wrinkled by use, knocked down and humiliated by a pair of laughing Nazis; after a ghastly mass murder come scenes in which the shooting of someone in the street is a commonplace, to be met with averted eyes.

As in early films like “Repulsion” (1965) and “Rosemary's Baby” (1968), Mr Polanski uses cinema's power to compress and expand time (leaps of months between scenes, suspense sequences that seem to take forever), recreating the Warsaw ghetto as a thought-inducing spectacle that seduces with a mixture of dread and fascination. Not only is Szpilman's story Mr Polanski's; he is a Polanski character, caught in a world of shape-shifting nightmares beyond which normal life (the city outside the ghetto walls) somehow goes on.

Szpilman escapes deportation by staying in the ghetto, and later by hiding in Warsaw apartments kept by the resistance, from which he watches the Jews' failed insurrection and the Polish Home Army's abortive attempts to retake the city. His last prison, revealed in a breath-taking pan-up after he escapes incineration in an abandoned hospital, is Warsaw itself, demolished by allied bombs, a winter landscape in which he seems to be the last living soul. Made with all-European financing, “The Pianist” allows Mr Polanski, whose output during his enforced exile from Hollywood declined in quality after the multi-Oscared “Tess” (1979), to show that he is still one of our greatest living film-makers. It deserved its Palme d'Or at Cannes.

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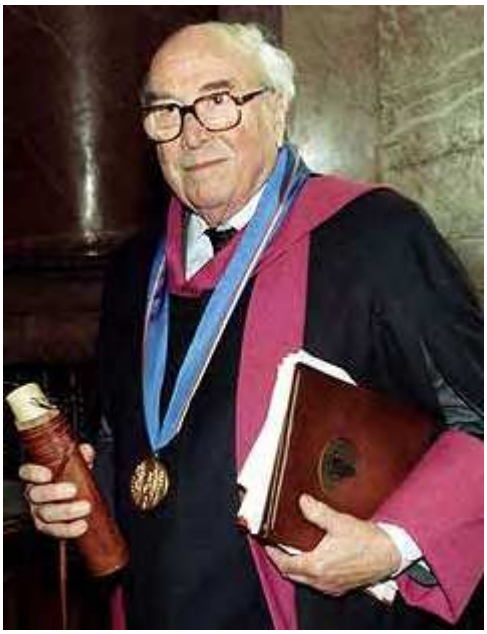
About sponsorship

Roy Jenkins

Jan 9th 2003
From The Economist print edition

Roy Jenkins, political reformist, died on January 5th, aged 82

Reuters



FOR the first 67 years of his life he was Roy Jenkins. For the remaining 15 years, in a curious British exercise in metamorphosis, he was a lord. The elevation suited him. He had a natural and agreeable grandeur. If you had to have lords, you could not do better than making Lord Jenkins the prototype. He usually had something interesting to say and said it well. He pursued some of the most progressive ideas in British politics over the past 50 years, but managed to be good humoured to his opponents as well as his supporters. To British voters, not terribly interested in politics between elections, he was nevertheless a character they warmed to, made all the more likeable by an engaging lisp and a taste for good living.

For all that, his political career could be judged a failure, although Enoch Powell, a gloomy seer (Obituary, February 14th 1998), said that was the fate of all politicians unless they died early. He held two of the highest offices of state, home secretary and chancellor of the exchequer (finance minister). He was reckoned to be a careful manager of the national purse, and he matched the tolerant mood of the 1960s by promoting laws that scrapped the censorship of the theatre, allowed abortion, stopped the punishment of flogging and ended the hounding of gays. But the big prize, that of prime minister, eluded him. As if in compensation, other rewards came his way. For three years, from 1977, he was president of the European Commission. In 1987 he was elected chancellor of Oxford University. His 19 books, mainly on political history, were well received. In 1993 he was appointed to the Order of Merit, a royal honour limited to 24 people.

In later years Lord Jenkins ruminated that although, in his view, he would have made a good prime minister, he lacked the ruthlessness that takes you to the very top. It was an odd contention by a political historian. To get anywhere in politics requires a degree of ruthlessness. More likely, he failed to make the final leap because, to quote Powell again, the position of prime minister “is filled by fluke”.

Goodbye to lunacy

In the obsequies that have followed Lord Jenkins's death this week it has been claimed that the policies of Britain's present Labour government are, in essence, his creation. The argument goes like this. In 1981, after he had left the European Commission, and the chance of leading the Labour Party and becoming prime minister was long past, he helped to form the Social Democratic Party. It rejected the “lunatic” leftist policies of the Labour Party and sought the “civilised” centre-left ground. The party had some by-election successes but never “broke the mould of British politics”, as it had hoped, and eventually merged with the Liberal Party to form the present Liberal Democrats, an opposition group in Parliament. However, the Jenkinsite ideas lived on and, so it is argued, were taken up by Tony Blair and his team, leading to a landslide victory in 1997 by New Labour, as it was now called.

Mr Blair was generous in his praise of “one of the most remarkable people ever to grace British politics” but he stopped short of saying that he had pinched his ideas. Blairites went through agonies ditching Labour's traditional policies, and do not want to share their success with anyone. If Lord Jenkins was indeed Mr Blair's mentor, his protégé has been a touch wayward, refusing to ally New Labour with the Liberal Democrats in Parliament, declining to reform the voting system to benefit the Liberals and refusing, so far, to swap the pound for the euro. An unusually irritated Lord Jenkins said that Mr Blair had

a “second-rate mind”.

No one doubted that the Jenkins mind was first rate. It was moulded in the valleys of Wales, a proving ground for many spinners of words, notably David Lloyd George and Dylan Thomas. His father, Arthur Jenkins, worked in the coal mines from the age of 12 for 24 years with a two-year break at Ruskin, an Oxford college for working people, and in 1935 became a Labour member of Parliament. Young Roy went to Oxford too, to Balliol, where he gained a first. In the second world war he worked at Bletchley, a country house where clever people broke enemy codes.

During Labour's first post-war government he entered Parliament as its youngest member. In Harold Wilson's government, which first took office in 1964, he rose rapidly. In 1965, aged 45, he was the youngest home secretary for 55 years. In 1970 he was deputy leader of the party and, as misleadingly happens in politics, was regarded as unstoppable. What may endure are his elegant words. Arguing for change in a much-quoted lecture in 1979 he said:

> Some societies, France in the second half of the Third Republic, pre-revolutionary Russia, the Austro-Hungarian empire, have been still less adaptable than our own. But they hardly provide grounds for comfort. Compared with post-war Germany, post-war Japan, Fifth Republican France (industrially at least), the United States for virtually the whole of its history...modern Britain has been sluggish, uninventive and resistant to voluntary change, not merely economically but socially and politically as well. We cannot successfully survive unless we can make our society more adaptable.

He usually had something interesting to say, and said it well.

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Overview

Jan 9th 2003
From The Economist print edition

The Dow Jones Industrial Average rose by 3.0%, as investors hoped that George Bush's proposed tax cuts would spur both equity-buying and the **American economy**. Markets also cheered a jump in the ISM'S manufacturing index, from 49.2 in November to 54.7 in December. (ISM readings above 50 signal expansion, those below contraction.)

Unemployment rose in Germany to 10.1% of the labour force in December, a four-year high. In the **euro area**, unemployment remained unchanged at 8.4% of the labour force in November. The 12-month growth in retail sales improved to 1.6% in October, but that is still less than half the pace of sales growth in the United States.

Switzerland's rate of consumer-price inflation held steady at 0.9% in December, still the second-lowest rate (after Japan's) of all the countries in the table. The Swiss franc has appreciated by 18% against the dollar over the past year. Swiss unemployment rose to 3.6% of its labour force in December, its highest for four-and-a-half years.

The price of **gold** hit a six-year high of $356 an ounce, as worries about a looming war in Iraq encouraged investors to seek a safe haven. **Oil** prices eased on expectations that OPEC will increase production by as much as 1.5m barrels a day to cover the shortfall caused by the strike in Venezuela. The price of West Texas Intermediate slipped to $30.35, from a recent high of $33.65.

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Output, demand and jobs

Jan 9th 2003
From The Economist print edition

% change on year ago

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr*	1 year	2002	2003	latest	latest	latest	year ago
Australia	+ 3.5	+ 3.7 Q3	+ 3.7	+ 3.2	+ 2.7 Q2	+ 5.4 Q3	6.1 Nov	6.8
Austria	+ 2.5	+ 0.9 Q2	+ 0.7	+ 1.3	− 2.9 Oct	+ 3.8 Oct	4.1 Nov	3.8
Belgium	+ 1.2	+ 0.8 Q3	+ 0.6	+ 1.4	+ 3.0 Oct	nil Oct	11.7 Dec†	10.8
Britain	+ 3.4	+ 1.8 Q3	+ 1.6	+ 2.4	− 1.2 Oct	+ 4.0 Nov	5.2 Oct††	5.1
Canada	+ 3.1	+ 4.0 Q3	+ 3.3	+ 3.1	+ 5.2 Oct	+ 7.0 Sep	7.5 Nov	7.6
Denmark	− 3.8	+ 0.9 Q3	+ 1.5	+ 1.8	+ 3.3 Oct	+ 7.5 Oct	5.4 Nov	5.0
France	+ 0.9	+ 0.8 Q3	+ 1.0	+ 1.6	− 0.6 Oct	+ 2.5 Nov	9.0 Nov	8.8
Germany	+ 1.1	+ 0.4 Q3	+ 0.2	+ 0.8	− 0.8 Oct	− 1.1 Oct	10.1 Dec§	9.5
Italy	+ 1.1	+ 0.5 Q3	+ 0.4	+ 1.3	− 2.1 Oct	− 0.7 Oct	8.9 Oct	9.3
Japan	+ 3.2	+ 1.3 Q3	− 0.3	+ 0.4	+ 4.5 Nov	− 1.8 Oct	5.3 Nov	5.4
Netherlands	+ 0.3	+ 0.1 Q3	+ 0.2	+ 1.0	− 1.4 Oct	+ 2.9 Oct	2.5 Nov**	2.0
Spain	+ 3.2	+ 1.8 Q3	+ 2.0	+ 2.3	+ 4.1 Oct	na	11.8 Nov	10.7
Sweden	+ 1.6	+ 2.0 Q3	+ 1.8	+ 2.1	− 1.5 Oct	+ 8.6 Oct	3.9 Nov†	3.7
Switzerland	+ 1.3	+ 0.6 Q3	− 0.1	+ 1.0	− 3.5 Q3	+ 2.6 Oct	3.6 Dec†	2.4
United States	+ 4.0	+ 3.2 Q3	+ 2.4	+ 2.5	+ 1.8 Nov	+ 3.3 Nov	6.0 Nov	5.6
Euro area	+ 1.3	+ 0.8 Q3	+ 0.7	+ 1.3	+ 0.3 Oct	+ 1.6 Oct	8.4 Nov	8.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 1.9	+ 2.3 Q3	na	na	+ 5.4 Nov	+ 1.1 Sep	8.2 Nov†	8.8
Greece	na	+ 3.6 Q3	na	na	+ 1.0 Oct	na	na	na
Iceland	na	+ 3.12001	na	na	+ 3.3 2001	na	2.8 Nov†	1.5
Ireland	na	+ 6.5 Q2	na	na	+16.9 Oct	+ 1.1 Oct	4.4 Nov	4.1
Luxembourg	na	+ 3.52001	na	na	− 1.4 Sep	− 5.6 Aug	3.3 Nov†	2.7
New Zealand	+ 5.0	+ 5.0 Q3	na	na	+ 4.3 Q2	+ 8.1 Q3	5.4 Q3	5.2
Norway	− 0.9	+ 1.0 Q3	na	na	− 5.1 Nov	+ 2.8 Oct	3.8 Q3	3.6
Portugal	+ 2.8	+ 0.9 Q2	na	na	− 3.7 Nov	+ 1.4 Oct	5.1 Q3†	4.0

*% change at an annual rate. †Not seasonally adjusted. ††Aug-Oct; claimant count rate 3.1% in Nov. §EU harmonised rate 8.5% in Dec. **Sep-Nov.

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Prices and wages

Jan 9th 2003
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2002	2003	latest		year ago	latest		year ago
Australia	+ 3.2	Q3	+ 2.5	+ 3.0	+ 2.7	– 0.2	Q3	+ 2.4	+ 3.6	Q3	+ 4.0
Austria	+ 1.7	Nov	+ 2.1	+ 1.8	+ 1.6	+ 0.8	Dec	– 1.1	+ 2.2	Nov	+ 2.7
Belgium	+ 1.4	Dec	+ 2.2	+ 1.7	+ 1.3	+ 1.5	Nov	– 3.6	+ 2.1	Q3	+ 3.7
Britain	+ 2.6	Nov	+ 0.9	+ 1.9	+ 2.5	+ 1.2	Nov	– 1.4	+ 3.7	Oct	+ 4.3
Canada	+ 3.2	Nov	+ 0.7	+ 2.2	+ 2.5	+ 2.2	Nov	– 2.1	+ 2.4	Oct	+ 2.5
Denmark	+ 2.7	Nov	+ 1.9	+ 2.4	+ 2.0	+ 0.8	Nov	– 1.2	+ 3.9	Q3	+ 4.3
France	+ 2.2	Nov	+ 1.2	+ 1.8	+ 1.5	+ 0.9	Nov	– 2.2	+ 3.4	Q3	+ 4.2
Germany	+ 1.1	Dec	+ 1.7	+ 1.3	+ 1.0	+ 1.1	Nov	– 1.9	+ 2.5	Oct	+ 2.3
Italy	+ 2.8	Dec	+ 2.4	+ 2.5	+ 2.1	+ 1.2	Nov	– 1.3	+ 2.1	Nov	+ 2.8
Japan	– 0.4	Nov	– 1.0	– 0.9	– 0.7	+ 0.3	Nov	– 0.8	+ 0.6	Nov	+ 0.6
Netherlands	+ 3.2	Nov	+ 4.2	+ 3.8	+ 2.5	+ 2.1	Nov	– 2.5	+ 3.4	Nov	+ 4.9
Spain	+ 3.9	Nov	+ 2.7	+ 3.5	+ 2.8	+ 1.7	Nov	– 0.8	+ 3.8	Q3	+ 3.6
Sweden	+ 2.3	Nov	+ 2.7	+ 2.4	+ 2.0	– 0.8	Nov	– 0.9	+ 3.1	Oct	+ 2.6
Switzerland	+ 0.9	Dec	+ 0.3	+ 0.7	+ 0.7	– 0.4	Nov	– 2.0	+ 2.5	2001	+ 1.3
United States	+ 2.2	Nov	+ 1.9	+ 1.6	+ 2.0	+ 0.9	Nov	– 1.2	+ 2.9	Nov	+ 3.9
Euro area	+ 2.2	Nov	+ 2.1	+ 2.2	+ 1.7	+ 1.1	Nov	– 1.3	+ 3.3	Q2	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.7	Nov	+ 1.7	na	na	+ 1.1	Nov	– 4.3	+ 3.5	Q3	+ 4.7
Greece	+ 3.6	Nov	+ 2.4	na	na	+ 2.1	Nov	– 0.5	na		na
Iceland	+ 2.0	Dec	+ 8.6	na	na	+ 4.6	Dec	+ 8.4	+ 5.7	Nov	+ 9.4
Ireland	+ 4.8	Nov	+ 3.8	na	na	– 1.2	Nov	nil	+ 6.2	Q3	+ 8.1
Luxembourg	+ 2.2	Nov	+ 2.1	na	na	+ 0.1	Oct	– 0.3	+ 1.6	Sep	+ 1.7
New Zealand	+ 2.6	Q3	+ 2.4	na	na	– 1.7	Q3	+ 6.2	+ 2.3	Q3	+ 2.0
Norway	+ 2.1	Nov	+ 1.8	na	na	+ 3.2	Nov	–23.2	+ 5.0	Q3	+ 4.8
Portugal	+ 4.0	Nov	+ 3.9	na	na	+ 1.7	Nov*	+ 0.6	+ 0.6	Sep*	na

*Revised series.

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Economic forecasts

Jan 9th 2003
From The Economist print edition

The Economist poll of forecasters, January averages (previous month's, if changed)

	Real GDP, % change				Consumer prices % increase		Current account % of GDP	
	Low/high range		average					
	2002	2003	2002	2003	2002	2003	2002	2003
Australia	3.4/3.8	2.70/3.7	3.7 (3.6)	3.2 (3.3)	3.0 (2.9)	2.7 (2.6)	-3.9(-3.8)	-4.1 (-3.9)
Austria	0.4/1.0	0.7/1.7	0.7 (0.6)	1.3 (1.6)	1.8	1.6 (1.7)	-0.4(-0.8)	-0.7 (-0.9)
Belgium	0.5/0.9	1.2/1.8	0.6	1.4 (1.7)	1.7	1.3 (1.4)	5.0 (5.1)	5.0
Britain	1.4/1.8	1.7/3.1	1.6	2.4 (2.5)	1.9	2.5 (2.4)	-1.7(-2.0)	-1.8 (-2.0)
Canada	3.2/3.5	2.6/3.7	3.3 (3.4)	3.1 (3.2)	2.2	2.5	1.9	1.9
Denmark	1.3/1.8	1.2/2.4	1.5 (1.6)	1.8 (2.0)	2.4	2.0 (2.1)	2.3 (2.2)	2.0
France	0.9/1.0	1.2/2.0	1.0	1.6 (1.8)	1.8 (1.9)	1.5 (1.4)	1.6	1.6
Germany	0.1/0.4	0.4/1.2	0.2 (0.3)	0.8 (1.1)	1.3 (1.4)	1.0 (1.1)	1.8 (1.4)	1.7 (1.1)
Italy	0.3/0.4	0.8/1.8	0.4	1.3 (1.5)	2.5	2.1 (2.0)	-0.1 nil	-0.1
Japan	-0.8/-0.1	-0.5/2.0	-0.3 (-0.5)	0.4 (0.7)	-0.9 (-1.0)	-0.7 (-0.6)	2.8	2.8
Netherlands	0.0/0.4	0.4/1.4	0.2 (0.3)	1.0 (1.4)	3.8 (3.7)	2.5	3.6 (3.0)	3.4 (3.2)
Spain	1.8/2.1	2.0/2.7	2.0 (1.9)	2.3 (2.4)	3.5 (3.4)	2.8 (2.7)	-2.1	-1.8 (-1.9)
Sweden	1.5/2.0	1.8/2.5	1.8 (1.7)	2.1 (2.3)	2.4 (2.3)	2.0	3.4 (3.3)	3.2 (3.3)
Switzerland	-0.3/nil	0.6/1.5	-0.1 nil	1.0 (1.2)	0.7	0.7 (0.8)	10.0(10.2)	10.3 (10.5)
United States	2.3/2.5	1.4/3.0	2.4	2.5 (2.6)	1.6	2.0 (2.1)	-4.7(-4.8)	-5.0
Euro area	0.1/0.8	1.0/1.6	0.7	1.3 (1.5)	2.2	1.7	0.6	0.7 (0.6)

Sources: ABN Amro, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, Merrill Lynch, J.P. Morgan Chase, Morgan Stanley, Nordea, Decision Economics, BNP Paribas, Royal Bank of Canada, Schroder Salomon Smith Barney, Scotiabank, Shinsei Bank, UBS Warburg

Every month *The Economist* surveys a group of forecasters and calculates the average of their predictions for economic growth, inflation and current-account balances for 15 countries and for the euro area. The table also shows the highest and lowest projections for growth. The previous month's forecasts, where different, are shown in brackets. The new year has brought little cheer. The panel has cut its growth forecasts for all 15 countries in 2003. The euro area is expected to grow by 1.3%, down from 1.5% in December. German GDP is predicted to rise by only 0.8%, down from 1.1% last month. Japan's growth forecast has also been cut from 0.7% to 0.4%, although last year's recession now looks relatively mild. The American economy is expected to grow this year by 2.5%, down from 2.6% in December. As in 2002, Australia and Canada are tipped to do best in 2003, growing by 3.2% and 3.1%.

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Money and interest rates

Jan 9th 2003
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Jan 8th 2003)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	– 8.1	+ 9.7	Nov	4.81	4.30	4.64	5.21	5.90	6.15
Britain	+ 6.8	+ 5.8	Nov	3.94	4.03	3.75	4.42	4.96	5.91
Canada	+ 9.8	+ 6.1	Nov	2.68	1.91	3.07	4.89	5.33	6.67
Denmark	+ 6.6	+ 6.2	Nov	3.14	3.75	3.03	4.47	5.04	6.80
Japan	+28.6	+ 3.2	Nov	0.03	0.03	0.05	0.89	1.38	1.02
Sweden	+ 1.8	+ 4.8	Sep	3.64	3.72	3.82	4.71	5.20	4.33
Switzerland	+12.3	+ 5.1	Nov	0.63	1.71	0.39	2.28	3.29	3.07
United States	+ 3.2	+ 6.6	Nov	1.28	1.75	1.69	3.97	5.06	6.34
Euro area†	+ 9.1	+ 7.1	Nov	2.85	3.33	2.69	4.19	4.82	4.72

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.93%, Japan No.24 0.885%. Central bank rates: US fed funds 1.25%, ECB refinancing 2.75%, BOJ overnight call 0.001%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jan 9th 2003
From The Economist print edition

1995=100

	Dec 24th	Jan 31st	Jan 7th*	% change on one month	% change on one year
Dollar index					
All items	75.8	74.7	76.3	+ 0.8	+12.9
Food	79.2	77.8	79.8	+ 1.8	+15.1
Industrials					
All	71.3	70.6	71.6	– 0.6	+ 9.8
Nfa†	73.6	74.0	74.4	– 0.4	+24.0
Metals	69.3	67.8	69.1	– 0.8	– 0.5
Sterling index					
All items	74.9	73.2	74.9	– 1.4	+ 1.4
Euro index					
All items	96.7	93.7	96.2	– 2.4	– 3.5
Yen index					
All items	96.9	94.4	97.5	– 2.0	+ 2.3
Gold					
$ per oz	345.50	342.75	349.00	+ 7.9	+25.2
West Texas Intermediate					
$ per barrel	31.93	31.30	31.17	+12.2	+49.6

* Provisional. † Non-food agriculturals.

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Stockmarkets

Jan 9th 2003
From The Economist print edition

Market indices

	Jan 8th	2002-03 high	2002-03 low	% change on one week	% change on record high	% change on Dec 31st 2001 in local currency	% change on Dec 31st 2001 in $ terms
Australia (All Ordinaries)	3,042.4	3,440.0	2,855.5	+ 2.2	-11.6	- 9.4	+ 1.4
Austria (ATX)	1,148.3	1,357.2	1,003.7	- 0.2	-33.9	+ 0.7	+17.5
Belgium (Bel 20)	1,984.7	2,899.8	1,773.7	- 2.0	-46.1	-28.7	-16.8
Britain (FTSE 100)	3,924.8	5,323.8	3,671.1	- 0.4	-43.4	-24.8	-17.3
Canada (Toronto Composite)	6,723.1	7,958.1	5,695.3	+ 1.6	-41.0	-12.6	-10.7
Denmark (KBX)	170.1	233.4	156.4	+ 2.3	-43.6	-24.3	-11.6
France (SBF 250)	2,074.7	3,081.9	1,794.5	+ 1.0	-52.7	-30.4	-18.8
(CAC 40)	3,094.1	4,688.0	2,656.5	+ 1.0	-55.3	-33.1	-21.9
Germany (Xetra DAX)	2,993.0	5,462.6	2,597.9	+ 3.5	-62.9	-42.0	-32.3
Italy (BCI)	1,123.8	1,513.0	974.4	+ 2.9	-48.5	-21.6	- 8.5
Japan (Nikkei 225)	8,517.8	11,979.9	8,303.4	- 0.7	-78.1	-19.2	-11.7
(Topix)	839.6	1,139.4	760.1	- 0.4	-70.9	-18.7	-11.1
Netherlands (AEX)	328.7	531.2	291.4	+ 1.9	-53.1	-35.1	-24.3
Spain (Madrid SE)	663.9	848.1	568.5	+ 4.7	-42.1	-19.5	- 6.0
Sweden (Affarsvarlden Gen)	148.0	236.8	122.7	+ 2.0	-63.0	-36.0	-23.3
Switzerland (Swiss Market)	4,882.3	6,694.1	4,435.0	+ 5.4	-42.0	-23.9	-10.1
United States (DJIA)	8,595.3	10,635.3	7,286.8	+ 3.0	-26.7	-14.2	-14.2
(S&P 500)	909.9	1,172.5	776.8	+ 3.4	-40.4	-20.7	-20.7
(NASDAQ Comp)	1,401.1	2,059.4	1,114.1	+ 4.9	-72.2	-28.2	-28.2
Europe (FTSE Eurotop 300)*	871.3	1,279.7	797.2	+ 1.7	-48.9	-30.9	-19.4
Euro area (FTSE Ebloc 100)*	734.6	1,125.1	639.4	+ 2.3	-52.6	-33.9	-22.9
World (MSCI)†	809.5	1,024.4	703.7	+ 2.2	-44.1	na	-19.3
World bond market (Salomon)‡	520.6	525.3	430.3	- 0.9	- 0.9	na	+18.4

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms. ‡Salomon Smith Barney World Government Bond Index, total return, in $ terms.

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About sponsorship

Trade, exchange rates and budgets

Jan 9th 2003
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		Current account % of GDP, forecast 2002	Current account % of GDP, forecast 2003	Exchange rate trade-weighted† 1990=100 Jan 8th	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Jan 8th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2002‡
Australia	− 3.3	Oct	− 14.3	Q3	− 3.9	− 4.1	74.6	74.9	1.74	1.91	2.79	1.81	1.45	0.1
Austria	− 0.2	Sep	− 0.9	Oct	− 0.4	− 0.7	101.1§	100.0	0.96	1.13	1.54	–	0.80	-1.6
Belgium	+ 16.7	Oct	+ 13.3	Sep	+ 5.0	+ 5.0	100.4§	98.8	0.96	1.13	1.54	–	0.80	nil
Britain	− 49.0	Oct	− 20.5	Q3	− 1.7	− 1.8	104.5	106.9	0.63	0.69	–	0.65	0.52	-1.4
Canada	+ 31.8	Oct	+ 12.4	Q3	+ 1.9	+ 1.9	75.5	75.7	1.56	1.60	2.50	1.62	1.30	0.6
Denmark	+ 7.4	Oct	+ 4.2	Oct	+ 2.3	+ 2.0	103.7	102.3	7.15	8.37	11.4	7.43	5.96	2.2
France	+ 9.0	Oct	+ 25.2	Oct	+ 1.6	+ 1.6	103.4§	101.4	0.96	1.13	1.54	–	0.80	-2.7
Germany	+112.9	Oct	+ 38.7	Oct	+ 1.8	+ 1.7	100.4§	98.1	0.96	1.13	1.54	–	0.80	-3.7
Italy	+ 11.1	Oct	− 2.8	Oct	− 0.1	− 0.1	73.7§	72.4	0.96	1.13	1.54	–	0.80	-2.3
Japan	+ 89.3	Oct	+113.9	Oct	+ 2.8	+ 2.8	132.0	127.4	120	133	192	125	–	-7.9
Netherlands	+ 26.9	Oct	+ 9.0	Q3	+ 3.6	+ 3.4	99.5§	97.7	0.96	1.13	1.54	–	0.80	-0.8
Spain	− 37.8	Oct	− 15.4	Sep	− 2.1	− 1.8	75.3§	74.1	0.96	1.13	1.54	–	0.80	nil
Sweden	+ 14.5	Nov	+ 11.1	Oct	+ 3.4	+ 3.2	78.8	75.8	8.75	10.4	14.0	9.09	7.29	1.7
Switzerland	+ 4.5	Nov	+ 29.8	Q3	+10.0	+10.3	116.0	112.0	1.40	1.66	2.25	1.46	1.17	na
United States	−456.6	Oct	−462.2	Q3	− 4.7	− 5.0	110.9	122.8	–	–	1.60	1.04	0.83	-3.1
Euro area	+ 94.2	Oct	+ 37.4	Oct	+ 0.6	+ 0.7	84.1	79.0	0.96	1.13	1.54	–	0.80	-2.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 12.7	Oct	+ 9.2	Oct	na	na	79.3§	78.3	0.96	1.13	1.54	–	0.80	3.2
Greece	− 20.7	Oct	− 8.1	Oct	na	na	58.2§	57.4	0.96	1.13	1.54	–	0.80	-1.1
Iceland	+ 0.2	Nov	nil	Q3	na	na	91.9**	84.9	80.8	102.1	129	83.9	67.4	0.3
Ireland	+ 35.2	Oct	+ 0.4	Q2	na	na	89.8§	87.1	0.96	1.13	1.54	–	0.80	-0.5
Luxembourg	− 2.7	Oct	+ 2.1	Q2	na	na	100.4§	98.8	0.96	1.13	1.54	–	0.80	1.8
New Zealand	− 0.5	Nov	− 1.7	Q3	na	na	93.1	83.4	1.89	2.34	3.02	1.96	1.58	1.6
Norway	+ 25.6	Nov	+ 25.0	Oct	na	na	108.1	96.6	6.96	8.94	11.1	7.23	5.81	12.4
Portugal	− 12.6	Sep	− 9.8	Sep	na	na	91.1**	90.2	0.96	1.13	1.54	–	0.80	-3.4

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, November average. ‡OECD forecast. **IMF, September average.

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About sponsorship

Government bonds

Jan 9th 2003
From The Economist print edition

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Overview

Jan 9th 2003
From The Economist print edition

Turkey's economy continues to rebound, and consumer-price inflation to fall. Industrial production rose by 8.6% in the year to November, faster than most analysts had expected. Consumer prices rose by 29.7% in the year to December, up from 31.8% in the year to November.

In the year to November, **Argentina's** trade surplus, boosted by a devalued currency, reached $16.3 billion, almost three times as big as the surplus in the year to November 2001. **Brazil's** trade surplus also rose sharply in 2002, to $13.1 billion.

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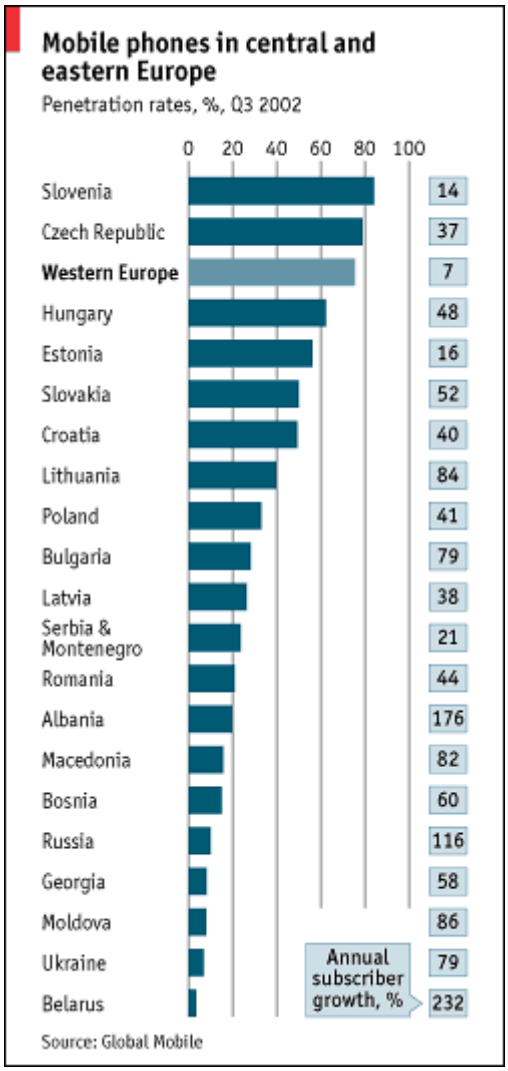
Mobile phones

Jan 9th 2003
From The Economist print edition

The proportion of central and eastern Europeans with mobile phones is rising fast, according to *Global Mobile*, an industry newsletter published by Baskerville. Annual growth in Russia, Belarus and Albania exceeds 100%, compared with a mere 7% in western Europe, where the market is nearing saturation in many countries. Russia accounts for over 20% of subscribers in the region and one-third of growth over the past year. Its low penetration (10%) is due to its large population and the concentration of mobile-phone subscribers around Moscow (where penetration, at around 50%, is comparable to America).



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Economy

Jan 9th 2003
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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 8.1	Q3	+14.5	Nov	– 0.7	Nov	+29.3	Nov	+17.4	2001	269.9	Oct
Hong Kong	+ 3.3	Q3	– 7.2	Q3	– 3.6	Nov	– 7.5	Nov	+16.5	Q3	111.6	Dec
India	+ 5.8	Q3	+ 6.2	Oct	+ 3.6	Nov	– 6.9	Nov	+ 4.5	Q3	67.0	Dec
Indonesia	+ 3.9	Q3	– 7.6	Jul‡	+10.0	Dec	+25.7	Nov	+ 6.9	Q2	29.0	Nov
Malaysia	+ 5.6	Q3	+ 6.4	Nov	+ 1.9	Nov	+13.5	Nov	+ 6.6	Q3	33.3	Nov
Philippines	+ 3.8	Q3	– 5.8	Oct	+ 2.6	Dec	+ 2.2	Oct	+ 6.1	Sep	13.0	Dec
Singapore	+ 2.6	Q4	– 0.7	Nov	+ 0.2	Nov	+ 8.5	Nov	+18.9	Q3	82.3	Dec
South Korea	+ 5.8	Q3	+ 7.1	Nov	+ 3.7	Dec	+11.3	Dec	+ 6.5	Nov	118.3	Nov
Taiwan	+ 4.8	Q3	+ 7.5	Nov	+ 0.8	Dec	+18.1	Dec	+25.0	Q3	161.7	Dec
Thailand	+ 6.0	Q3	+10.9	Nov	+ 1.6	Dec	+ 4.8	Nov	+ 7.8	Nov	36.9	Nov
Argentina	–10.1	Q3	– 5.4	Nov	+40.5	Nov	+16.3	Nov	+ 3.9	Q2	10.0	Nov
Brazil	+ 2.4	Q3	+ 8.9	Oct	+10.9	Nov	+13.1	Dec	– 9.4	Nov	35.6	Nov
Chile	+ 1.8	Q3	+ 0.2	Nov	+ 2.8	Dec	+ 2.6	Nov	+ 0.9	Q3	15.2	Nov
Colombia	+ 1.9	Q3	+ 5.3	Oct	+ 7.0	Dec	+ 0.1	Oct	– 1.3	Q2	10.6	Nov
Mexico	+ 1.8	Q3	+ 1.3	Oct	+ 5.4	Nov	– 8.3	Nov	–16.1	Q3	46.8	Nov
Peru	+ 4.5	Oct	+ 3.1	Oct	+ 1.5	Dec	+ 0.3	Oct	– 1.0	Q3	9.2	Nov
Venezuela	– 5.5	Q3	– 6.6	Jul	+31.2	Dec	+11.4	Q3	+ 4.9	Q3	8.8	Oct
Egypt	+ 4.9	2001†	+ 7.8	2001†	+ 2.8	Oct	– 8.0	Sep	+ 0.1	Q3	12.9	Sep
Israel	– 0.8	Q3	+11.8	Oct	+ 6.7	Nov	– 6.3	Nov	– 1.9	Q3	24.1	Nov
South Africa	+ 3.1	Q3	+ 4.3	Oct	+14.5	Nov	+ 3.6	Nov	nil	Q3	6.0	Nov
Turkey	+ 7.9	Q3	+ 8.6	Nov	+29.7	Dec	–12.8	Oct	+ 0.6	Oct	26.0	Nov
Czech Republic	+ 1.5	Q3	+ 3.5	Oct	+ 0.5	Nov	– 3.6	Nov	– 4.2	Q3	23.6	Dec
Hungary	+ 3.4	Q3	+ 0.8	Oct	+ 4.8	Nov	– 3.0	Nov	– 3.3	Nov	9.8	Nov
Poland	+ 1.6	Q3	+ 2.8	Nov	+ 0.9	Nov	–10.2	Nov	– 6.7	Nov	28.5	Nov
Russia	+ 4.3	Q3	+ 0.8	Nov	+15.1	Dec	+44.1	Oct	+27.6	Q3	44.5	Nov
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	– 0.5	Jun	+ 3.1	Nov	– 1.3	Dec	+ 2.7	2002†	7.3	Nov
Saudi Arabia	+ 1.2	2001	na		– 0.9	Oct	+44.1	2001	+14.5	2001	21.4	Nov

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series.
Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Jan 9th 2003
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jan 8th		Dec 31st 2001	
	Jan 8th	year ago	Jan 8th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	13.2	na	1,433.3	+1.0	– 16.3	– 16.3
Hong Kong	7.80	7.80	12.5	1.43	9,688.2	+3.9	– 15.0	– 15.0
India	48.0	48.3	76.7	5.43	3,357.9	–1.0	+ 2.9	+ 3.5
Indonesia	8,930	10,420	14,284	13.57	389.4	–8.4	– 0.7	+ 15.7
Malaysia	3.80	3.80	6.08	3.10	625.1	–3.3	– 10.2	– 10.2
Philippines	53.5	51.6	85.6	6.81	1,040.4	+2.2	– 10.9	– 14.1
Singapore	1.74	1.85	2.78	0.91	1,332.3	–0.6	– 17.9	– 12.9
South Korea	1,184	1,307	1,894	4.86	651.7	+3.9	– 6.1	+ 4.2
Taiwan	34.5	35.0	55.3	1.75	4,836.9	+8.6	– 12.9	– 11.7
Thailand	42.8	44.1	68.4	1.87	360.4	+1.1	+ 18.6	+ 22.6
Argentina	3.30	1.40	5.27	6.50	569.9	+8.6	+ 92.9	– 41.4
Brazil	3.31	2.37	5.29	24.90	11,785.5	+4.6	– 13.2	– 39.3
Chile	711	669	1,137	2.64	5,008.5	–0.2	– 7.2	– 13.7
Colombia	2,896	2,307	4,633	7.70	1,672.9	+4.0	+ 56.2	+ 22.8
Mexico	10.34	9.20	16.5	7.97	6,266.5	+2.3	– 1.7	– 12.8
Peru	3.49	3.46	5.58	3.60	1,439.4	+3.4	+ 22.5	+ 20.8
Venezuela	1,572	759	2,514	22.39	8,015.2§	nil	+ 22.0	– 41.2
Egypt	4.59	4.60	7.34	5.53	5,496.6	+2.3	+ 4.3	+ 3.9
Israel	4.83	4.45	7.73	6.08	329.6	–0.0	– 26.2	– 32.7
South Africa	8.6	11.4	13.8	13.60	9,378.5	+1.1	– 10.2	+ 25.1
Turkey	1,670,000	1,405,500	2,671,332	42.00	10,161.2	–2.0	– 26.3	– 35.8
Czech Republic	30.2	36.3	48.4	2.64	464.2	+0.8	+ 17.6	+ 38.3
Hungary	226	274	362	8.37	7,809.3	+0.1	+ 9.5	+ 33.0
Poland	3.86	3.97	6.17	6.63	14,738.0	+2.6	+ 5.9	+ 8.5
Russia	31.9	30.6	51.0	21.00	354.8	–1.2	+ 42.6	+ 36.4
EMF (MSCI)*	1.00	1.00	1.60	na	302.1	+3.4	na	– 4.8
EMBI+†	1.00	1.00	1.60	na	232.8	+1.7	na	+ 16.2

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. § Nov 29th.
Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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